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REPORT BY THE

Comptroller General

OF THE UNITED STATES

COMPLETED

ORIGINAL

Lessons To Be Learned From Offsetting The Impact Of The Soviet Grain Sales Suspension

The Department of Agriculture took actions to offset the impact on farmers of the January 1980-April 1981 Soviet grain sales suspension. These actions were aimed at stabilizing market prices and included purchase and resale of exporters' undeliverable Soviet grain contracts and removal of the suspended grain from the market. Primarily because of the short time between the decision to suspend shipments and the suspension's announcement, the offsetting actions were implemented inefficiently. This inhibited price recovery and unduly increased costs and Federal losses.

GAO recommends actions that Agriculture should take in offsetting the impact of any future suspension. The report also discusses Federal monitoring of the suspension and the suspension's impact on the Soviet Union.

UNITED STATES GENERAL ACCOUNTING OFFICE

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A

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-199124

The Honorable Charles E. Grassley
United States Senate

The Honorable Douglas K. Bereuter
The Honorable E. Thomas Coleman
The Honorable Glenn L. English
The Honorable Thomas M. Hagedorn
The Honorable Larry J. Hopkins
The Honorable William C. Wampler
House of Representatives

This report discusses the Department of Agriculture's actions to offset the impact of the Soviet grain sales suspension. It identifies certain areas in which the Department's offsetting actions increased Federal costs and losses. It also recommends that the Secretary develop a contingency plan to more efficiently offset the effects of any future suspension.

We made this review in response to your April and May 1980 requests that we investigate the (1) effectiveness of the Federal Government's monitoring program, (2) circumstances surrounding the Department of Agriculture's Commodity Credit Corporation's assumption and retender of U.S. grain exporters' contracts with the Soviet Union, and (3) propriety of the Corporation's open-market purchases of wheat and corn.

On March 3, 1981, we issued a classified report (C-CED-81-1) dealing with the effectiveness of the Federal monitoring program and the suspension's impact on the Soviet Union. An unclassified summary of that report is included as chapters 5 and 6 of this report.

As arranged with your offices, we are sending copies of this report to other interested committees and Members of Congress; the Director, Office of Management and Budget; and the Secretary of Agriculture.

Milton J. Socolar
Acting Comptroller General
of the United States

REPORT BY THE
COMPTROLLER GENERAL
OF THE UNITED STATES

LESSONS TO BE LEARNED FROM OFFSETTING THE IMPACT OF THE SOVIET GRAIN SALES SUSPENSION

DIGEST

On January 4, 1980, the President announced that for foreign policy and national security reasons, the Federal Government was suspending the shipment of about 18 million metric tons of agricultural commodities--primarily wheat and corn--to the Soviet Union. The President directed the Department of Agriculture to take actions to offset the suspension's impact on farmers.

These offsetting actions, most of which were concerned with stabilizing market prices, included

--removing the suspended grain from the market by increasing the wheat and corn price-support loan rates, adjusting the farmer-owned reserve program, and purchasing grain directly from farmers and country grain elevators and

--purchasing exporters' undeliverable grain contracts with the Soviet Union. (See pp. 6 and 7.)

This was the first time that the Federal Government had attempted to offset a suspension's impact on the U.S. agricultural sector. In April and May 1980 eight Members of Congress asked GAO to investigate and report on various Federal actions concerning the suspension. Lessons learned in offsetting this suspension, which the President lifted on April 24, 1981, should play a major role in offsetting any future suspensions.

LACK OF TIME TO ADEQUATELY PLAN OFFSETTING ACTIONS

Because of the short time between the decision to suspend shipments and the suspension's announcement, Agriculture was not able to thoroughly analyze the suspension's potential impact and develop a comprehensive plan of offsetting actions. (See p. 9.)

The lack of adequate planning caused Agriculture to (1) erroneously anticipate that the farmer-owned reserve would efficiently remove the undeliverable grain, (2) purchase the exporters' Soviet contracts valued at about $2.4 billion with little documentation that such purchase was necessary, and (3) inefficiently implement the offsetting actions. It took Agriculture almost 6 months to complete these actions. (See pp. 9 to 18.)

Under the Export Administration Act of 1979, any administration may suspend the export of agricultural commodities. Such action may have severe effects on the grain production and marketing industries. Accordingly, it is important that the potential effects of the various actions or combination of actions that could be taken to most efficiently offset the potential impact of any future suspensions be identified and analyzed. (See p. 14.)

IMPLEMENTATION OF OFFSETTING ACTIONS INCREASED COSTS AND LOSSES

Agriculture's purchase and resale of the exporters' Soviet contracts and its purchase of corn and wheat from farmers were two major actions taken to offset the suspension's impact. Agriculture implemented these actions in a manner which led to Federal losses or increased Federal costs.

Agriculture's Commodity Credit Corporation purchased a total of 202 exporters' contracts involving 14.4 million metric tons of corn, wheat, soybeans, and soybean products valued at about $2.4 billion. The Corporation and exporters agreed to deductions from the contract prices for exporters' profits and short-inventory positions, if applicable. These deductions are to be made at final settlement. (See pp. 22 and 23.)

The contracts called for delivery between January and August 1980; however, Agriculture negotiated delayed delivery dates with the exporters for most contracts at an additional cost of about $163 million. Between March 27 and August 7, 1980, the Corporation resold these contracts, mostly to the same exporters, for about $2.1 billion, resulting in a provisional loss to the Government of about $475 million pending final settlement. (See pp. 22 and 25 to 27.)

The Corporation could have decreased this loss by about $75.5 million if it had not made a questionable purchase of soybean and soybean product contracts. (See pp. 27 and 28.)

The Corporation required that an amount be deducted from the contract purchase price if an exporter had not yet purchased grain to fully cover its

Soviet sales. However, this deduction does not cover the exporters' presuspension sales to countries other than the Soviet Union for which the exporters had not yet purchased grain. Because of the lower grain prices caused by the suspension, the exporters may have realized greater profits than they anticipated on these sales. In determining actions to offset the suspension's impact, the Corporation should have considered all potential profits caused by the suspension. (See pp. 29 and 30.)

The Corporation also entered into 43,929 separate contracts with farmers and grain elevators to purchase 4.1 million metric tons of corn and 4.2 million metric tons of wheat at a cost of about $978 million. If the Corporation continues to own much of this grain until the end of fiscal year 1981, it will spend about $141 million to store, handle, and transport the purchased grain. (See p. 34.)

The Corporation purchased grain at prices substantially above market prices, purchased some low-quality grain at high prices, and purchased wheat varieties not involved in the suspension. These actions unduly increased Federal purchase costs. It is not possible to determine if the grain purchase will result in a net gain or loss until the Corporation sells the grain. (See pp. 35 to 40.)

Agriculture also experienced problems in administering the purchase program. For example, Agriculture's State and county offices could not answer farmers' questions because of the untimely dissemination of purchase instructions. Officials in most of the 4 State and 15 county offices GAO visited stressed the purchase program's administrative problems. (See pp. 40 and 41.)

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

To help ensure that the effects of any future suspensions are offset in a more orderly, systematic, and timely manner, the Secretary should develop and keep current a contingency plan that would include

--an assessment of existing farm programs to determine if they are flexible enough to efficiently and effectively offset the impact of a grain sales suspension on farmers;

- --an evaluation of the types and availability of data needed to determine on short notice the extent and severity of a suspension's impact on farmers, grain elevators, grain transporters, and exporters; and

- --an analysis of the extent, if any, to which the impact on each of the agricultural sectors should be offset.

After assessing existing farm programs, the Secretary should develop and submit to the Congress any legislative recommendations for modifying the existing programs or instituting new programs that the Secretary finds are necessary in developing a contingency plan. (See pp. 19 and 20.)

If the Corporation again considers purchasing exporters' contracts to offset the impact of future suspensions, the Secretary should direct it to

- --prepare an economic justification for each commodity involved in the suspension to determine if such purchase is necessary and

- --estimate any suspension-related benefits and detrimental effects to the exporters, and use both estimates in determining the extent of Federal assistance needed. (See p. 33.)

If the Corporation again considers open-market purchases as an offsetting action, the Secretary should direct it to purchase only the types and grades of commodities suspended from shipment and to make such purchases at prices at or near the existing market prices. (See p. 41.)

IT IS DIFFICULT TO MONITOR A GRAIN SALES SUSPENSION

The Federal Government set up a monitoring program to identify illegal grain shipments to the Soviet Union. The monitoring program, which was discontinued with the lifting of the suspension in April 1981, was reasonably successful in identifying and/or discouraging direct shipments from U.S. ports to the Soviet Union. However, it was not feasible to closely monitor for possible unauthorized transshipments because of factors inherent in monitoring any grain sales suspension. These include the fungibility, or interchangeability, of grain; the relatively widespread availability of transshipment facilities; and limitations in staff resources and U.S. legal jurisdiction.

The Soviet Union probably received some U.S. grain during the embargo as a result of unauthorized transshipments. Agriculture officials could not estimate the amount that might have been involved. (See pp. 42 to 45.)

SOVIET UNION ABLE TO SUBSTANTIALLY OFFSET GRAIN SHORTFALL

In the 1979-80 marketing year (July 1979 through June 1980), the Soviet Union was able to substantially offset the suspension's impact by

--increasing grain imports from other countries;

--drawing down its carryover grain stocks;

--increasing imports of non-U.S. soybeans, soybean products, and substitute feeds; and

--increasing meat imports. (See pp. 46 to 49.)

Before the suspension was lifted, Agriculture estimated that even with the U.S. grain sales suspension, the Soviet Union would have imported an amount of grain about equal to its maximum import capabilities during the 1980-81 marketing year. (See pp. 49 and 50.)

AGENCY COMMENTS

Agriculture said that not only did the past grain sales suspension appear to be only minimally effective with respect to its intended objectives, but contingency planning for future unexpected disruptions of agricultural trade is extremely difficult, if not impractical, in light of such unpredictable variables as global weather conditions, world crop supplies and prices, the world economic situation trading pattern, and overall trade relations with our trading partners. It said that although it may be useful to discuss the possible adverse impacts of an overall U.S. trade suspension on the agricultural community, it should be recognized that the effects of such embargoes cannot be readily quantified. (See app. VI.)

GAO agrees that the adverse impact of any future trade suspension cannot be readily quantified and that the stated unpredictable variables will play a role in deciding on the need for, as well as the type and extent of, offsetting actions to be taken. However, GAO believes that developing a plan consistent with the framework outlined in its recommendation is important.

Agriculture also commented on other specific issues. Its letter and GAO responses to these comments are in appendix VI.

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ABBREVIATIONS

FASB	Financial Accounting Standards Board
GAO	General Accounting Office
USDA	U.S. Department of Agriculture

CHAPTER 1

INTRODUCTION

On January 4, 1980, the President of the United States announced the suspension of grain shipments to the Soviet Union in excess of the 8 million metric tons of wheat and corn which the United States was committed to export by the U.S.-U.S.S.R. Grain Supply Agreement. Shipments to the Soviet Union of soybeans and other agricultural commodities that could be used for feeding livestock were also suspended. At the time the suspension was announced, exporters had contracts with the Soviet Union for about 18 million metric tons of corn, wheat, soybeans, and soybean products. The suspension was imposed in response to the Soviet invasion of Afghanistan in late December 1979. The President's action was taken for reasons of national security and foreign policy as authorized by the Export Administration Act of 1979, as amended (50 U.S.C. App. 2401 et seq.).

The President directed the U.S. Department of Agriculture (USDA) to offset the suspension's impact on farmers. USDA's Commodity Credit Corporation had primary responsibility for implementing the offsetting actions. In response, the Corporation increased the price-support loan rates for wheat and corn, increased the price levels at which grain would be released or called from the farmer-owned grain reserve, and waived the first year's interest on loans to farmers putting corn in the farmer-owned reserve. To help stabilize wheat and corn market prices, the Corporation purchased (1) U.S. grain exporters' Soviet contracts which could not be delivered [1] and (2) wheat and corn from country grain elevators and farmers.

Section 6 of the Export Administration Act requires that export controls, such as the Soviet grain sales suspension, which are taken for foreign policy reasons will expire after 1 year unless extended. In the January 7, 1981, Federal Register, the Secretary of Commerce announced that the suspension would be renewed. On April 24, 1981, the President announced that the suspension had been lifted.

U.S.-U.S.S.R. GRAIN SUPPLY AGREEMENT

The suspension did not totally eliminate U.S. grain exports to the Soviet Union. U.S. grain sales to the Soviet Union are governed by a 5-year U.S.-U.S.S.R. Grain Supply Agreement, which covers the period from October 1, 1976, through September 30, 1981. The agreement requires the Soviet Union to buy at least 6 million metric tons of wheat and corn annually and allows it to purchase an additional 2 million metric tons without prior authorization of the U.S. Government. For purchases over 8 million metric tons, U.S. Government authorization is required.

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[1] For the purpose of contract purchases, eligible exporters were those firms that had export facilities in the United States for the purpose of exporting U.S. agricultural commodities.

On October 3, 1979, the Soviet Union received permission to purchase up to 25 million metric tons of U.S. wheat and corn during the fourth year of the agreement (October 1979 through September 1980). When the suspension was announced, the Soviet Union had contracted for about 22 million metric tons of U.S. wheat and corn, of which 5.5 million metric tons had been loaded or shipped.

SOVIET DEPENDENCY ON U.S. AGRICULTURAL EXPORTS

The United States intended the suspension to have major political and economic implications. According to USDA officials, the suspension was meant to communicate to the Soviet Union that it could not engage in aggression and expect to maintain normal trade and business relations with the United States. The suspension was directed at the important feed/livestock sector of the Soviet economy.

Before the 1971-72 grain marketing year (July 1-June 30), Soviet strategy was to import only minimal amounts of grain. Between 1956-57 and 1970-71, except for especially poor production years in 1963 and 1965, the Soviet Union's average grain imports amounted to 1.6 million metric tons annually. Beginning in the 1971-72 marketing year, the Soviet Union began importing large quantities of grain, largely from the United States, to increase livestock herds and meat consumption. From the 1971-72 through the 1978-79 marketing years, Soviet grain imports (excluding rices and pulses) averaged 14.5 million metric tons, 62 percent of which the United States supplied. In 1979-80 the Soviet Union was expected to import about 25 million metric tons of U.S. grain, but because of the suspension, they were able to import only 14 million metric tons of U.S. grain.

Although Soviet yearly imports of U.S. grain have fluctuated, the following table shows that, except for 1974-75, the United States has accounted for a majority of Soviet grain imports since 1972-73.

Soviet Imports of Grain from the United States 1971-72 through 1978-79

Year (note a)	Wheat	Coarse grains (note b)	Total	Percent of total Soviet imports
	------(million metric tons)-----			
1971-72	-	2.9	2.9	37
1972-73	9.5	4.2	13.7	61
1973-74	2.7	5.2	7.9	72
1974-75	1.0	1.3	2.3	44
1975-76	4.0	9.9	13.9	54
1976-77	2.9	4.5	7.4	72
1977-78	3.3	9.2	12.5	68
1978-79	2.9	8.3	11.2	74

a/Data is for July-June marketing year.

b/Excludes rice and pulses.

AGRICULTURAL EXPORTS OF INCREASING IMPORTANCE TO THE UNITED STATES AND ITS FARMERS

According to USDA statistics, U.S. agricultural exports in the late 1970's provided a sales outlet for about one-third of the U.S. harvested crop acreage and accounted for about one-fifth of the net farm income. Agricultural exports are crucial to the U.S. balance of payments position. In 1979, for example, the dollar amount of agricultural exports exceeded the dollar amount of agricultural imports, resulting in a trade surplus of about $18 billion.

The importance of U.S. grain exports to the Soviet Union grew rapidly during the 1970's. Before 1970 the United States shipped very little grain and soybeans to the Soviet Union.

OBJECTIVES, SCOPE, AND METHODOLOGY

In April 1980 six members of the House Committee on Agriculture asked us to investigate and report on the (1) circumstances surrounding the Corporation's purchase and subsequent resale of grain exporters' contracts with the Soviet Union, (2) effectiveness of the Federal monitoring program to ensure that U.S. grain was not being shipped to the Soviet Union, and (3) propriety of the Corporation's open-market purchases of wheat and corn. (See app. I.) In May 1980 Congressmen Douglas Bereuter and Glenn English separately asked that we do similar work. (See apps. II and III.) This report covers the Corporation's purchase and resale of the exporters' contracts and its open-market purchases of wheat and corn. In addition, the report discusses the Corporation's identification and implementation of actions to offset the suspension's impact. On March 3, 1981, we issued a classified report (C-CED-81-1) dealing with the effectiveness of the Federal monitoring program and the suspension's impact on the Soviet Union. An unclassified summary of that report is included as chapters 5 and 6 of this report.

The purchase and resale of exporters' contracts was primarily handled by Corporation personnel located in Washington, D.C. We examined the pertinent policies, procedures, reports, and records relating to the purchase and resale. We reviewed contract data supplied by the exporters and the determination of payments to the exporters. For much of the review, we were in daily contact with Corporation personnel handling the transactions.

We did not audit the exporters' books to determine the effect on the exporters of the suspension or of USDA's actions to offset the suspension's impact. As part of USDA's Office of Inspector General's overall monitoring of the offsetting actions, it was charged with the responsibility for auditing the exporters to determine the accuracy of their profit and loss statements and short-inventory position statements which will form the basis for final USDA payments to the exporters. The Inspector General planned to complete this audit by the middle of July 1981. We had frequent discussions with the Inspector General's staff and reviewed their audit results through June 1981.

In reviewing the actions taken to offset the suspension's impacts, we frequently encountered a lack of adequate documentation in the Corporation's files. Not only did we find cases of inadequate documentation of the Corporation's market purchases of wheat and corn, but this problem was especially prevalent regarding the Corporation's purchase and resale of exporters' undeliverable Soviet contracts. In many cases statements from Corporation officials and penciled notes were the only support offered for Corporation decisions.

The Corporation's market purchases of wheat and corn were handled by the Corporation's Board of Directors; USDA's Agricultural Stabilization and Conservation Service headquarters in Washington, D.C.; the Service's State and county offices; and the Service's Kansas City Commodity Office. We examined and analyzed records at headquarters and at selected Service State and county offices in Kansas, Nebraska, Oklahoma, and Iowa. (See app. IV.) Many of the Corporation's wheat purchases were from farmers and grain elevators in Kansas, Nebraska, and Oklahoma; a large quantity of corn was purchased in Iowa. At all Service levels, we interviewed personnel responsible for determining and administering policies governing the purchase program.

On many occasions we discussed with high-level USDA officials, some of whom were also on the Corporation's Board of Directors, policy decisions concerning the (1) suspension, (2) purchase and resale of exporters' contracts, and (3) market purchases of wheat and corn. We also interviewed officials of (1) the Commodity Futures Trading Commission, (2) three large grain-exporting firms, (3) various grain trade associations located in four

States and Washington, D.C., (4) two agricultural consulting firms, and (5) a major agricultural university to obtain their opinions on USDA's actions to offset the suspension's impact.

In developing information on the Government's monitoring program, it became necessary to obtain and use data contained in classified documents. Accordingly, our March 3, 1981, report, which contains information on the monitoring program, was classified.

The Government's monitoring effort included various departments and agencies, such as the Departments of Agriculture, State, Commerce, and the Navy, and the Central Intelligence Agency. No memorandums of understanding or guidelines were prepared to outline the duties and responsibilities of each department or agency involved in the monitoring effort. To determine the duties and responsibilities of each department or agency, we (1) interviewed Agriculture, State, and Commerce officials in Washington, D.C., and (2) analyzed these Departments' reports and records. Officials from the Department of the Navy and the Central Intelligence Agency were reluctant to talk with us about their roles in the monitoring effort. Therefore, to determine their roles, we had to rely on discussions with officials of the above-mentioned Departments and examinations of weekly summaries of the monitoring effort.

Some of the data concerning the suspension's impact on the Soviet Union is based on estimates for which no direct confirmation by official Soviet statistics is anticipated. Thus, this data may not be totally accurate or reliable, but it represents the best available information.

We did not contact other grain-exporting countries to verify USDA estimates of their grain exports to the Soviet Union. USDA estimates, however, are based on data supplied by these grain-exporting countries.

CHAPTER 2

A CONTINGENCY PLAN SHOULD BE DEVELOPED TO OFFSET IMPACT OF FUTURE SUSPENSIONS

On January 5, 1980, the Secretary of Agriculture estimated that in the absence of any Federal actions to offset the decline in agricultural prices caused by the suspension, 1980 farm income and the value of agricultural exports would each decrease by about $3 billion, and consumer prices would experience a small but essentially negligible decrease.

Starting on January 8, 1980, the Corporation took a series of actions to offset the suspension's anticipated impact. The primary objective of the actions was to stabilize farm prices and protect farm income basically by decreasing the supply of grain available in the marketplace. The Corporation reasoned that if an amount of grain equal to the amount suspended was removed from the market, the suspension's impact would be offset.

The Corporation had less than 1 day to analyze the suspension's potential impact and to develop a comprehensive plan of offsetting actions between the decision to suspend grain shipments to the Soviet Union and the suspension's announcement. This short time available for analysis led the Corporation to (1) erroneously anticipate that the farmer-owned reserve would efficiently remove an amount of corn similar to the amount suspended from shipment and (2) purchase U.S. exporters' undeliverable grain contracts with the Soviet Union with little documentation that such purchases were necessary. In addition, the Corporation's major offsetting actions--removal of grain from the market and purchase and resale of the exporters' contracts--were inefficiently implemented. These problems inhibited the recovery of corn and wheat market prices.

If the Corporation had been better prepared to offset a suspension's impact, it may not have made these mistakes. The Corporation should develop and keep current a contingency plan to help ensure that the effects of any future suspensions are offset in a more orderly, systematic, and timely manner.

ACTIONS TAKEN TO STABILIZE FARM INCOME AND MARKET PRICES

The offsetting actions announced by the Corporation in early January 1980 included (1) increasing the wheat and corn price-support loan rates, (2) increasing the release and call prices for grain in the farmer-owned reserve, (3) waiving the first year's interest on loans to farmers putting corn in the farmer-owned reserve, (4) increasing the reserve storage payments, and (5) purchasing the exporters' contractual obligations with the Soviet Union for U.S. wheat, corn, soybeans, and soybean products that would not be shipped. In addition, the Corporation purchased wheat and corn from farmers and grain elevators.

The wheat and corn price-support loan rates act as a floor under the commodities' market prices. Increasing the loan rates provides farmers with added income protection. After harvest a farmer may request a price-support loan from the Corporation in an amount equal to the loan rate--generally set by the Secretary within a range set by law--multiplied by the quantity put under loan. The farmer has the option of (1) repaying the loan before or at maturity, (2) giving the Corporation title to the grain as full payment for the loan, or (3) placing the grain, if eligible, in the farmer-owned reserve.

The increases in the farmer-owned reserve's release and call prices were intended to allow market prices to increase more before wheat and corn would be taken or forced out of the reserve and onto the market. A farmer who puts grain in the reserve receives a loan and storage payment from the Corporation. Such grain cannot be sold without penalty until the national average market price, as computed by USDA, reaches a predetermined release level. When the market price reaches the release level, the farmer can, but does not have to, remove the grain from the reserve. If the national average market price continues to rise, it may reach the call level, at which point the Corporation calls in all reserve loans on that grain. At the call level, the farmer has the choice of repaying the loan or forfeiting the grain to the Corporation.

The Corporation anticipated that waiving first-year interest on corn reserve loans and increasing the reserve storage payments would encourage farmers to put an amount of corn in the reserve equal to the amount suspended from shipment. The Corporation believed that the suspension's impact would be offset if the grain supply and demand situation could be made the same as if the suspension had not occurred.

The Corporation offered to purchase exporters' contractual obligations for U.S. wheat, corn, soybeans, and soybean products previously committed for shipment to the Soviet Union. In January 1980 the Secretary of Agriculture testified before the Joint Economic Committee that if the contracts had not been honored, many of the exporters would not have been able to meet financing commitments and would have been forced to sell the undeliverable grain at any price. He said that this forced selling of grain would have caused prices to plummet resulting in millions of dollars in losses and bankruptcies throughout the grain-marketing system.

The Corporation's corn and wheat purchases from elevators and farmers were intended to decrease the available supply in the marketplace.

SUSPENSION'S IMPACT ON MARKET PRICES

Government officials expected a substantial drop in wheat and corn prices in the short term as the market adjusted to the news of a potentially large reduction in U.S. grain exports.

The grain market responded as anticipated. Cash prices fell significantly during the first week of the suspension. For example, between January 3 and January 10, 1980, cash corn prices in Chicago dropped from $2.62 to $2.30 a bushel.

However, by February 5, 1980, market prices for wheat were above presuspension levels and corn prices were slightly below presuspension levels. In mid-February the corn and wheat price recovery stalled. Throughout much of the spring, wheat prices declined. For example, on February 15 the Kansas City market price for wheat was $4.29 a bushel; by the end of March the price had decreased to $3.74 a bushel. Corn prices on the Chicago market during this period remained at or below mid-February levels. Finally, in May 1980 both wheat and corn prices started to move upward. A drought in major U.S. grain-producing areas was a significant factor in improving grain prices.

During 1980 wheat and corn prices were affected by many factors, including the suspension and the Corporation's offsetting actions. Some of these factors were

--published USDA estimates in late January that 1980 corn production would reach record levels,

--sharply increased interest rates,

--a drought in major U.S. grain-producing areas in late spring and summer, and

--record-level agricultural exports despite the suspension.

Because of the variety and interaction of factors which affected corn and wheat prices throughout 1980, we were unable to accurately measure the suspension's impact on prices or the results of the Corporation's actions to stabilize prices.

Others' opinions about the suspension's impact on prices and the results of the offsetting actions varied. For example, the Congressional Research Service reported that USDA's former Director of Economics, Policy Analysis, and Budget had said that the suspension had a negative effect on prices during the first 6 months of the year but that he believed that the suspension's impact on prices was negated as a result of the Corporation's offsetting actions. An econometric modeling firm believes that the suspension had only a minor adverse impact on 1980 prices because of the Corporation's offsetting actions, steps taken by the Congress, and the relatively small amount of grain involved in the suspension compared with total U.S. grain production. (See p. 28.) However, some farm organizations believe that throughout 1980, the suspension caused prices to be lower than they otherwise would have been.

A January 1981 Congressional Research Service report [1] indicated that the suspension may have eased what might have been a short-supply situation. It said:

> "Although it is not possible to determine accurately what the domestic situation would have been had the embargo not been imposed, it seems likely that, given the reduced crop prospects resulting from the drought, the U.S. would be facing an appreciably tighter supply/demand situation. This could have, among other things, disrupted exports to our traditional customers, caused U.S. livestock producers to pay sharply higher feed costs, and raised domestic food prices."

CORPORATION'S OFFSETTING ACTIONS NOT BASED ON THOROUGH ANALYSIS

The Corporation had little time between the decision to suspend grain sales and the suspension's announcement to (1) thoroughly analyze available agricultural estimates to measure the suspension's potential impact on U.S. agriculture and (2) identify actions which, if taken, would efficiently offset this impact. This led the Corporation to (1) erroneously anticipate that the farmer-owned reserve would efficiently remove from the market an amount of grain equal to the amount of grain suspended from shipment and (2) purchase exporters' undeliverable contracts with the Soviet Union with little documentation that such purchase was necessary.

Just days before the suspension announcement, the Corporation gave the President's advisors updated estimates of U.S. grain production, carryover stocks, market prices, and export levels. However, USDA's former Director of Economics, Policy Analysis, and Budget said that there was insufficient time to thoroughly analyze these estimates.

Farmer-owned reserve did not efficiently remove corn from market

The Congress authorized the establishment of a farmer-owned reserve program in the Food and Agriculture Act of 1977 (Public Law 95-113, 91 Stat. 913). One of the reserve's objectives is to remove grain from the market during periods of surplus supply and to have these stocks flow back into the market in times of short supply.

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[1] "Agriculture: U.S. Embargo of Agricultural Exports to U.S.S.R.," Issue Brief Number IB80025, Congressional Research Service, Jan. 14, 1981.

On January 8, 1980, the Corporation adjusted the reserve program to encourage farmers to place additional grain in the reserve. [1] The Corporation anticipated that the reserve would efficiently remove from the market an amount of corn about equal to the amount of undeliverable corn, or about 9 million metric tons. However, by the end of March 1980, or about 3 months after the suspension was announced, the reserve had removed only 4.3 million metric tons of corn, or 48 percent of the corn suspended from shipment.

USDA's former Director of Economics, Policy Analysis, and Budget, who was a member of the Corporation's Board of Directors, said that in March 1980 it became evident that the reserve program would not efficiently remove the amount of corn involved in the suspension. Accordingly, the Corporation decided to take two additional actions--open the reserve to previously ineligible farmers and make direct purchases. [2] The Director said that the Corporation would purchase an amount of corn that, when added to the amount of corn removed from the market by the reserve, would at least equal the corn suspended from shipment. He added that the Corporation had hoped that it would have to purchase only a small amount of corn.

The law in effect at the time of the suspension provided that to be eligible for the reserve, a farmer must have set aside from production a certain percentage of farm acreage if the Secretary had announced such a set-aside program. In 1979 a corn crop set-aside program was in effect, but only 20 percent of U.S. corn farmers had participated. Therefore, in March 1980 the Corporation asked the Congress for the authority to open the reserve program to farmers who had not participated in the 1979 corn set-aside program. In April 1980 the President signed legislation (Public Law 96-234, 94 Stat. 333) which gave the Secretary that authority. The Secretary opened the reserve to previously ineligible farmers until 7.5 million metric tons were placed in the reserve or until June 15, whichever came first. Only 1.2 million metric tons of corn were entered in the reserve by such farmers.

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[1] The reserve program adjustments were primarily implemented to remove corn from the market. The Corporation, prior to and unrelated to the suspension, had planned to purchase about 4 million metric tons of wheat to augment foreign food assistance programs. After the suspension was announced, the Corporation decided that the planned wheat purchases--which were for about the same amount as that involved in the suspension--would be used for the assistance program. However, in the initial stage of the suspension, the Corporation decided to remove corn from the market through the farmer-owned reserve, not through purchases.

[2] The Corporation had purchased a small quantity of corn in February 1980 to alleviate congestion in corn storage facilities.

According to the Corporation, one of the major reasons the reserve did not efficiently remove the corn from the market during the suspension's early stages was because most corn farmers were not eligible to put corn into the reserve. In fact, however, quantities of corn substantially greater than the amount suspended had been eligible for the reserve. In January 1980 the Corporation surveyed 77 percent of the farms eligible for the reserve to determine the amount of corn intended to be placed in the reserve. The survey indicated that these farms had 17.4 million metric tons of corn, or about twice the amount suspended, eligible for the reserve but that only 4.6 million metric tons would be put into the reserve.

Corporation officials told us that the reserve's failure to efficiently remove corn from the market during the suspension's early stages inhibited price recovery. In all, actions to remove the corn from the market took about 6 months. Corporation officials told us that the Corporation should have begun to purchase the corn earlier to assist the reserve in removing the quantity of corn suspended from shipment.

Purchase of exporters' contracts not based on adequate documentation

On January 7, 1980, the Vice President of the United States announced that the Corporation was prepared to purchase U.S. grain exporters' contractual obligations for corn, wheat, and soybeans previously committed for shipment to the Soviet Union. Subsequently, the Corporation purchased contracts valued at about $2.4 billion for about 9 million metric tons of corn, 4 million metric tons of wheat, and 1.1 million metric tons of soybeans and soybean products. The decision to purchase the contracts was based primarily on oral justification supplied by the exporters.

Corporation officials told us that at the time the suspension was announced, they were unaware of the magnitude of the suspension's impact on exporters holding grain contracts with the Soviet Union. At the exporters' request, Corporation officials met with them on Sunday, January 6, 1980, to discuss the suspension's impact on the domestic grain trade. The exporters told these officials that most of the grain needed to fulfill the Soviet contracts had been purchased from elevators and farmers or had been hedged on the commodity futures market. The exporters said that because the suspension canceled those sales, they would probably be forced to (1) dump large quantities of grain on the market thereby depressing grain prices and/or (2) cancel grain purchase contracts with domestic grain elevators and farmers. In addition, they said that the suspension would force some exporters into bankruptcy. The exporters stressed that they would be forced to take these actions immediately.

The exporters did not present documentation to support these oral claims. They were able, however, to convince Corporation officials that these claims were valid. These officials said that if exporters dumped grain or canceled contracts, the effect on the U.S. grain trade would have been devastating. In the end, farmers would have gotten substantially less for their grain.

Corporation and exporter officials told us that the Corporation had asked the exporters what types of Federal action were necessary to prevent the exporters from taking these measures. One of the actions suggested was that the Government purchase the exporters' undeliverable grain contracts.

A Corporation official told us that the purchase of the exporters' contracts had been discussed with the President's advisors before the suspension was announced. However, the possibility of this purchase was not publicized immediately after the suspension was imposed because USDA's General Counsel was determining whether the Corporation could legally purchase exporter contracts.

On January 6, 1980--the same day as the Corporation/exporter meeting--the General Counsel determined that the Corporation had the authority to carry out the purchase under the Commodity Credit Corporation Charter Act, as amended (15 U.S.C. 714 *et seq*.). Under section 2 of the act, the purposes of the Corporation are to (1) stabilize, support, and protect farm income and prices, (2) assist in the maintenance of balanced and adequate supplies of agricultural commodities, and (3) facilitate the orderly distribution of agricultural commodities. Section 5 of the act specifically authorizes the Corporation to (1) remove and dispose of surplus agricultural commodities and (2) export, or cause to be exported, agricultural commodities. The General Counsel determined that sections 2 and 5 of the act gave the Corporation the authority to purchase the contracts.

The General Counsel also determined that before purchasing the contracts, the Corporation would have to demonstrate that the farmer was the main beneficiary of the contract purchases. In announcing the purchase, the Vice President said that this action was being taken to stabilize farm product prices and to ensure that the burden of the suspension would not fall unfairly on farmers. Corporation officials told us that it would have been impossible to delay the decision to purchase the contracts without causing a significant adverse impact on grain prices. Because of this anticipated impact, the Corporation concluded that the contract purchase was necessary to protect the farmers' welfare.

We believe that under then-existing conditions, the Corporation's quick action in this regard was reasonable. If exporters had dumped large amounts of grain on the market or canceled grain contracts with suppliers, grain prices would have decreased even more than they actually did. We believe, however, that in the future a decision involving such a substantial dollar amount should be based on more than oral information.

In retrospect, we believe the Corporation could have taken certain other actions that might have negated the need to purchase the exporters' contracts as a means to support prices. For example, price-support loan rates for both corn and wheat could have been temporarily increased to equal presuspension market prices. Price-support loan rates were increased but remained well under presuspension market prices. Because market prices rarely fall below loan rates for any appreciable length of time, the increase in loan rates would have propped up market prices. Also, such an increase in loan rates would have encouraged farmers to put more of their wheat and corn under loan, thus decreasing the available supply in the marketplace. If the increased loan rates would have succeeded in maintaining prices around presuspension levels, the exporters may not have found it necessary to dump the grain and/or cancel contracts. A Corporation official told us that such an alternative might have been successful in propping up prices, but the official expressed concern that loan rates would have remained at that level after the suspension's impact was offset.

Either as a separate action or in conjunction with increasing price-support loan rates, the Corporation could have purchased from the market any excess grain supplies caused by the suspension. However, Corporation officials told us that at the time the Corporation did not want to purchase corn. (See p. 10.) They believed that to do so would put the Government in competition with the farmer-owned reserve program. However, it later became necessary for the Corporation to purchase corn to offset the suspension's impact. In fact, Corporation officials said that the Corporation's delay in purchasing the corn hindered price recovery.

In commenting on our draft report (see app. VI), USDA disagreed that raising loan rates for corn and wheat to equal presuspension market prices would have been an appropriate action. It said that to raise the loan rates to presuspension market price levels would have caused the Corporation to become the principal source of credit and sharply increased the nonrecourse (price-support) loans extended to producers. It said that unless market prices would have reached levels to make redemption possible (loan rate plus interest plus storage costs), the Corporation would have become the owner of the grain, which would have eventually had the same implications as direct grain purchases. It added that extreme difficulty would have been encountered in reducing loan rates to levels more commensurate with their stated purposes once the situation had been corrected.

In discussing increasing loan rates to presuspension market price levels, we were only giving an example of an action that might have negated the need to purchase exporters' contracts as a means to support prices. We agree that raising the loan rates would have encouraged an increase in the number of loans. However, it should be pointed out that the Corporation took other actions that were directed toward the same goal. For example, both wheat and feed grain loan rates were increased, although not to presuspension market levels. Also, immediately after the suspension was announced, the Corporation adjusted the reserve program by increasing release and call levels, waiving the first year's interest on corn reserve loans, and increasing reserve storage payments. Each of these actions was intended to encourage farmers to place more grain under reserve loans.

Also, we question whether the increase in loan rates would have resulted in the Corporation owning more corn than it ended up owning after the direct purchase program. Further, we believe that the Corporation could have later reduced the loan rates without the difficulty it anticipated if it had made clear that the loan rate increases to presuspension price levels were only temporary until the suspension's impact was offset.

Corporation officials told us that regardless of any action to prop up prices, many of the exporters would have been forced to dump grain because the Commodity Futures Trading Commission limits the amount of speculation a trader can do on the futures market. Speculation is defined as purchasing contracts for grain in excess of outstanding sales. The loss of Soviet sales which were backed by grain purchases would put many exporters in a long-inventory position--purchases in excess of sales. Corporation officials reasoned that because of the size of the long positions, the Commission would force many exporters to drop their speculative positions. Commission officials told us, however, that under its emergency powers authority, the Commission could have waived the speculative limit for those exporters affected by the suspension.

Obviously, the Corporation had little time and no concrete information on which to base the decision to purchase the exporters' contracts. Also, we recognize that the Corporation had no previous experience to assist it in determining the actions necessary to offset the suspension's impact. But we believe that if price stabilization was the Corporation's primary goal, there were alternatives to purchasing the exporters' contracts. Unfortunately, determining if the contract purchases, the alternatives discussed above, or some other means would have been the most efficient means of offsetting the suspension's impact is not possible. Events occurring in 1980 neither proved nor disproved that the Corporation's decision to purchase the exporters' contracts was the most efficient means of stabilizing prices.

Under the Export Administration Act of 1979, any administration may suspend the export of agricultural commodities. Such action may have severe effects on the grain production and marketing industries. Accordingly, we believe it is important that the Corporation identify and analyze the potential effects of the various actions or combination of actions that could be taken to most efficiently offset the potential impact of any future suspensions. The purchase of exporter contracts should be one of the actions analyzed.

MANNER IN WHICH OFFSETTING ACTIONS WERE IMPLEMENTED INHIBITED PRICE RECOVERY

The Corporation's major actions to stabilize prices--removing from the market a quantity of grain similar to the quantity suspended from shipment and purchasing and reselling the exporters' suspended Soviet contracts--were inefficiently implemented. It took almost 6 months to complete these actions. More efficient implementation of the removal actions would have more rapidly offset the suspension's impact on market prices.

Corporation's concern for the future of farm programs caused corn removal action to be inefficient

It took the Corporation about 6 months after the suspension was announced to reach its price-stabilization objective of removing from the market an amount of corn equal to the amount suspended. Much of the delay in meeting the Corporation's objective can be attributed to its inefficient implementation of the corn removal actions. The primary reasons for this poor implementation were the Corporation's concern that (1) opening the reserve to previously ineligible farmers could adversely affect participation in future set-aside programs and (2) direct purchases of corn by the Corporation would adversely affect the reserve program.

As discussed previously, the reserve did not prove to be an efficient method of removing corn from the market. In January 1980 the Corporation opposed opening the reserve to ineligible farmers. A Corporation official told us that the Corporation believed that opening the reserve would adversely affect future set-aside programs. He said that farmers who participated in the 1979 set-aside program to be eligible for the reserve program would be less willing to participate in the future if farmers who did not participate became eligible for the reserve.

However, in March 1980 when it became evident that the reserve was not efficiently removing the corn, the Corporation asked the Congress for authority to open the reserve. The Corporation said that if first-year interest costs were not waived for ineligible farmers, as had already been done for eligible farmers, the eligible farmers would be more willing to participate in future set-aside programs.

In addition, the Corporation did not begin to purchase corn until March to assist the reserve in efficiently removing the corn from the market. (The Corporation did purchase a small amount of corn in February.) A Corporation official told us that the Corporation delayed making this purchase even though it recognized that it would be an efficient method of removing corn from the market. Corporation officials said that the decision to purchase corn was an agonizing one because any corn the Corporation owned would be in direct competition with the reserve.

Furthermore, the purchases would again put the Corporation in a position of owning corn stocks--a situation which the reserve was to make unnecessary.

A Corporation official said that the reserve allowed farmers to retain ownership of the corn, and thus the farmers had a chance to profit from subsequent corn sales. Corporation ownership of the corn obviously would give the Corporation this profit opportunity.

We recognize that the Corporation's concerns about the future of the set-aside and reserve programs were genuine. But these concerns caused delays in meeting the Corporation's objective of stabilizing market prices by efficiently removing surplus corn supplies from the market. We believe that existing farm programs need to be examined to determine if they are flexible enough to offset the impact of any future suspension, or if adjustments in these programs are necessary to meet such emergency situations. If such flexibility were built into these programs, farmers would probably be more likely to continue participating in them even after the emergency provisions were invoked.

Corporation efforts to remove wheat and soybeans also inefficient

In early January 1980 the Corporation announced that it would take delivery on the contracts purchased from the exporters involving about 4 million metric tons of wheat for a reserve to augment foreign food assistance programs. At that time the Congress was considering legislation authorizing such a reserve.

As wheat prices declined in much of February and in March, the Corporation changed its position on taking delivery on the exporters' contracts and in March began to purchase a quantity of wheat similar to the amount suspended from shipment. The Corporation decided to resell the exporters' wheat contracts. It made this decision to purchase wheat, rather than accept delivery on the exporters' contracts, to prop up falling wheat prices. A sufficient quantity of wheat had been purchased by mid-April.

Although the Corporation had continually taken the position since January that corn and wheat would be removed from the market to offset the suspension's impact, it was silent on removing soybeans from the market. It was not until April, in the face of falling soybean prices caused by a market oversupply, that the Corporation announced it would purchase about 123,000 metric tons of soybeans. However, the Corporation made no attempt to purchase soybeans over the next few weeks. Then, in early May 1980 the Corporation announced that it would not purchase any soybeans. A Corporation official told us that the decision was based on a request by a major soybean producer organization that did not want the Corporation to own soybean stocks.

Because of its extensive farm programs, USDA actions exert a substantial influence on commodity markets. For example, a major exporting firm said that the recovery of commodity prices in January and early February 1980 was caused mainly by the Corporation's announcement of its offsetting actions. However, the firm believes that the Corporation's delay in implementing these actions, such as removing the grain involved in the suspension, was a major cause of the price decline that started in February and continued through most of the spring of 1980.

Delays in contract liquidation inhibited price stabilization

Following the Vice President's January 7, 1980, announcement that the Corporation would offer to purchase the exporters' suspended grain and soybean contracts, the Corporation purchased contracts valued at about $2.4 billion for 9 million metric tons of corn, 4 million metric tons of wheat, and 700,000 metric tons of soybeans in February 1980. In May 1980 the Corporation purchased contracts covering about 400,000 metric tons of soybean products valued at about $120 million. The soybean contracts were resold beginning in March 1980; however, the Corporation did not begin reselling the corn and wheat contracts until May 1980.

Many knowledgeable officials said that the Corporation should have begun reselling the contracts earlier. They said that uncertainty in the market concerning the Corporation's disposition of the contracts hindered price recovery. For example,

--officials of a large exporting firm said that the contracts hung over the marketplace offsetting the Government's price-recovery efforts;

--officials of a large investment company reported in a baking trade publication that with the contracts overhanging the market, the potential recovery of agricultural prices diminishes; and

--a USDA official said in a draft intradepartmental memorandum to the Secretary that a great deal of confusion and uncertainty existed in the marketplace concerning the Corporation's policy on reselling the contracts and that the confusion and uncertainty created market instability.

Part of the delay in reselling the contracts can be attributed to the negotiations between the Corporation and the exporters on the original purchase terms and conditions. The Corporation did not legally purchase the contracts until mid-February 1980--6 weeks after the suspension was announced.

Much of the delay in reselling the corn and wheat contracts between mid-February and May can be attributed to uncertainty within USDA about the market price level at which sales should begin. A variety of policy options had been discussed, including whether the sales should begin (1) when corn and wheat market prices were equal to or above their January 4 levels or (2) when the prices reached USDA's presuspension projected monthly 1980 corn and wheat prices.

A significant disparity existed between these two price levels. Before the suspension USDA had projected that (1) wheat prices would decrease about 25 cents a bushel between January and June 1980 and (2) corn prices would increase about 3 cents a bushel per month. Thus, using USDA-projected prices as the criteria for beginning contract sales, wheat contracts could be sold when market prices were below their January 4 levels; however, corn contracts would not be sold until market prices were above their January 4 levels.

An April 1980 draft memorandum to the Secretary from an assistant to the Under Secretary for International Affairs and Commodity Programs stated that wheat prices had remained well below the presuspension level. The memorandum pointed out that as long as the Corporation held the exporters' wheat contracts, wheat prices would probably remain below this level. According to this memorandum, holding these contracts until wheat prices increased would be self-defeating. The memorandum discussed a possible sales program for the wheat contracts that could have been implemented immediately.

Another April 1980 draft memorandum to the Secretary from the assistant to the Under Secretary recommended that a sales program for the corn contracts be implemented even though corn price levels had remained below the USDA-projected level. It said that a variety of non-suspension-related factors, such as increased estimates of corn crop production and high interest rates, contributed to the corn price weakness. The memorandum concluded that because the Corporation had removed over 6 million metric tons of corn from the market through its farmer-owned reserve and purchase program, the weaknesses in corn prices must be explained by the non-suspension-related factors. Further, the memorandum pointed out that as in the case of wheat, the Corporation-owned contracts hung over the market and prevented prices from increasing.

In late April 1980 the Corporation announced that both the corn and wheat contracts would be sold beginning in May 1980.

CONCLUSIONS

Starting on January 8, 1980, the Corporation took a series of actions to offset the suspension's anticipated impact. The Corporation had little time to thoroughly analyze the suspension's potential impact and to develop a comprehensive plan of offsetting actions between the decision to suspend grain shipments to the Soviet Union and the suspension's announcement.

Opinions differ on the suspension's impact on prices and the result of the offsetting actions. Wheat and corn prices decreased in the first week after the suspension but recovered to presuspension levels by early February. However, from early February through May 1980, wheat prices declined and corn prices remained at or slightly below presuspension levels. Both wheat and corn prices, bolstered by a drought in major U.S. grain-producing areas, moved upward throughout the remainder of 1980. Other factors also affected prices in 1980.

According to Corporation officials, the suspension's impact on prices would be offset when an amount of grain equal to the amount suspended was removed from the market. It took the Corporation about 6 months to remove sufficient quantities of corn from the market and about 3 months to remove enough wheat. Much of the delay in removing the corn from the market can be attributed to the inability of the farmer-owned reserve to remove enough corn. The Corporation delayed implementing actions to assist the reserve in removing corn--opening the reserve to previously ineligible farmers and direct purchase of corn--because of concern that such actions would adversely affect existing farm programs.

The delay in removing wheat from the market was caused primarily by a Corporation decision in January to take delivery of wheat involved in the exporter contracts rather than use the reserve or direct purchases. However, because of declines in wheat prices, the Corporation in March and April purchased an amount of wheat equal to the amount suspended from shipment.

Because of the little time available between the decision to suspend shipments and the suspension's announcement to thoroughly analyze the suspension's impact on U.S. agriculture, the Corporation purchased exporters' undeliverable contracts with the Soviet Union valued at about $2.4 billion with little documentation that such a purchase was necessary. The Corporation had no plan to resell these contracts. Many believe that the Corporation's delay in reselling these contracts inhibited price recovery.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

We recommend that to help ensure that the effects of any future suspension are offset in a more orderly, systematic, and timely manner, the Secretary develop and keep current a contingency plan that would include

--an assessment of whether existing farm programs are flexible enough to efficiently and effectively offset the impact of a grain sales suspension on farmers;

--an evaluation of the types and availability of data needed to determine on short notice the extent and severity of a suspension's impact on farmers, grain elevators, grain transporters, and exporters; and

--an analysis of the extent, if any, to which the impact on each of the agricultural sectors should be offset.

We also recommend that after assessing existing farm programs, the Secretary develop and submit to the Congress any legislative recommendations for modifying existing programs or instituting new programs that the Secretary finds are necessary in developing a contingency plan.

AGENCY COMMENTS AND OUR EVALUATION

According to USDA (see app. VI), the administration is strongly opposed to the use of export controls in a manner which unfairly burdens any sector of the American economy. It added that this administration did not invoke the partial grains embargo--it revoked it.

In commenting on our recommendation to develop a contingency plan to help ensure that the effects of any future suspensions are offset in a more orderly, systematic, and timely manner, USDA said that while it may be useful to discuss the possible adverse impacts of an overall U.S. trade suspension on the agricultural community, it should be recognized that the effects of such embargoes cannot be readily quantified. It said that not only did the past agriculture embargo appear to be only minimally effective with respect to its intended objectives, but contingency planning for future unexpected disruptions of agricultural trade is extremely difficult, if not impractical, in light of such unpredictable variables as global weather conditions, world crop supplies and prices, the world economic situation trading pattern, and overall trade relations with our trading partners.

We agree that the adverse impacts of any future trade suspension cannot be readily quantified and that the stated unpredictable variables will play a role in deciding on the need for, as well as the type and extent of, offsetting actions to be taken. For these reasons, we agree that it is impractical to develop a detailed contingency plan that covers all possible variables and levels of adverse impacts. However, we believe that developing a plan consistent with the framework outlined in our recommendation is important. If a lesson can be learned from the Soviet grain sales suspension, it is that too little time existed between the decision and its announcement to develop a comprehensive set of offsetting actions.

Without (1) analyzing the effectiveness of the offsetting actions, (2) identifying problems encountered in implementing these actions, and (3) considering the need to make changes in existing farm programs or develop new legislation to facilitate offsetting a suspension's impact, we would anticipate that the Government would face the same problems and the same uncertainties that were faced when considering the imposition of the Soviet grain sales suspension. In essence, we would have learned no lesson from this past experience.

USDA also said that it disagreed with our conclusion that the farmer-held grain reserve was ineffective in that it failed to remove 9 million tons of corn from the market as anticipated.

It said that the reserve had an announced purpose other than to withhold supplies of commodities for an unusual occurrence such as the grain embargo. It added that USDA officials had to consider the integrity of the reserve program as it related to actions contemplated subsequent to the grain embargo.

Arguing whether the reserve was intended to remove grain from the market in situations such as the suspension seems irrelevant. A stated purpose of the reserve is to increase grain inventories in times of abundant supply. The cause of such abundant supply should have no bearing on the operation of the reserve.

Further, as stated on page 16, we recognize that the Corporation's concerns about the future of both the reserve and set-aside programs were genuine. As we also state, however, if the flexibility to offset the impact of any future suspension was built into these programs, farmers would probably be more likely to continue participating in them even after the emergency provisions were invoked.

CHAPTER 3

PURCHASE AND RESALE OF EXPORTERS' CONTRACTS A COSTLY ACTION

Shortly after the Corporation's January 7, 1980, offer to purchase the exporters' undeliverable Soviet contracts, it began negotiating an agreement with the exporters. By February 15 the final agreement to purchase wheat, corn, and soybean contracts had been signed by 12 of the 14 exporters holding Soviet contracts. The exporters who chose not to participate had relatively small amounts of grain sales to the Soviet Union. A separate agreement for purchasing soybean product contracts was signed in May 1980. Three exporters, one of which had no grain or soybean contracts, signed this agreement.

The Corporation subsequently purchased a total of 202 contracts involving 14.4 million metric tons of corn, wheat, soybeans, and soybean products valued at about $2.39 billion. The purchased contracts had provided for delivery of the products to the Soviet Union during the period January through August 1980. The Corporation negotiated later dates for taking delivery on most of the contracts which increased its purchase cost by about $163 million. Between March 27 and August 7, 1980, the Corporation resold these contracts, mostly to the same exporters, for about $2.08 billion for a gross loss of about $475 million. The net loss will not be determined until USDA's Office of Inspector General completes its verification of the profit and loss and short-inventory statements which the exporters had submitted to the Corporation. The Corporation/exporter agreement requires an amount to be deducted from the Corporation's purchase price for these factors.

Actions taken by the Corporation when purchasing and selling the contracts unduly increased the loss by $75.5 million through the questionable purchase of soybean and soybean product contracts. An undetermined amount of additional losses which cannot now be avoided will be incurred when final payments are made to the exporters. These losses are the result of inadequate recovery of potential exporter profits and increased interest costs caused by delays in making the final payments.

NEGOTIATED AGREEMENT WITH EXPORTERS

Between January 7 and January 30, 1980, the Corporation and the exporters worked out a standard agreement that was acceptable to all parties. In early February 1980 the agreement was sent to each exporter to be signed. By February 15 the final agreement had been signed by all but two exporters that had been identified as holding Soviet contracts. These two exporters decided to dispose of their own contracts.

Under the agreement a Soviet contract eligible to be purchased by the Corporation was one that was (1) entered into before

January 4, 1980, (2) properly reported under the Export Sales Reporting Act (7 U.S.C. 612c-3), and (3) not deliverable due to the suspension. The Corporation agreed to purchase the exporters' contracts at their sale prices, with certain price adjustments.

The agreement authorized the following adjustments to the contract sale prices to determine the Corporation's purchase price.

--Upward or downward adjustment to the exporter's contract price for removal of terms and provisions unique to Soviet sales. For example, most Soviet contracts called for the application of a special insecticide, malathion, which is not commonly used as an insecticide for shipments going to other countries. Such adjustments were deemed necessary because the Corporation's disposition of the contracts would be to buyers other than the Soviet Union.

--Deduction from the purchase price for the exporter's pretax profit margin. The Corporation's purchase offer had stressed that the purchase was to protect against losses, not to guarantee profits.

--Deduction from the purchase price if an exporter had not fully purchased the grain involved in its Soviet sale contracts. Exporters that had not covered their contracts with purchases (that is, exporters that were in a short position) could have earned additional profits by buying grain at lower postsuspension prices.

The agreement authorized the Corporation to take delivery on the contracts or sell them. The agreement also authorized the Corporation to delay taking delivery--that is, "roll over" the delivery month. If the Corporation rolled over the contract delivery month, it agreed to pay the exporter a negotiated premium to cover the exporter's additional costs, such as storage and interest costs. The Corporation found it necessary to roll over the delivery month on many contracts because (1) the contracts' delivery months had passed before the Corporation could consummate assumption agreements and establish administrative procedures to sell them or (2) large quantities of grain had been scheduled for shipment to the Soviet Union during a single month and the Corporation thought that selling contracts involving large quantities of grain could adversely affect the market. The Corporation rolled over contracts for periods ranging from 1 to 12 months at a cost of $162.8 million.

As it sold a contract, the Corporation paid the exporter 97 percent of the contract purchase cost and 100 percent of the rollover premium, if applicable, during the contract's delivery month. The Corporation retained the remaining 3 percent pending determination of the profit and short-inventory deductions. The Corporation's payment method varied depending on whether the contract was sold to a third party or the original owner.

--If the exporter was awarded its own contract, the Corporation paid the exporter on the first working day after the fifteenth of the delivery month. The amount paid was the difference between (1) 97 percent of the Corporation's contract purchase cost plus 100 percent of the rollover premium and (2) the exporter's purchase cost to buy the contract from the Corporation.

--If a bidder was awarded a contract other than its own, payment was made at any time during the delivery month when the Corporation received evidence that delivery had been made. The successful bidder would pay the Corporation the contract's purchase cost and, in turn, the Corporation would pay the exporter that originally held the contract 97 percent of the Corporation's purchase cost and 100 percent of the rollover premium.

Contract purchases

In accordance with the agreement's provisions, each exporter submitted a list of all its eligible contracts showing quantities, sale prices, delivery dates, and export ports. Adjustments were made to the listings for converting Soviet contract terms to standardized provisions and for removing those contracts that were allowed to be shipped up to 8 million metric tons.

In total, 202 separate contracts valued at about $2.6 billion, including rollover costs, were purchased from 13 exporters. The exporters were Alfred C. Toepfer International, Incorporated; Bunge Corporation; Cargill, Incorporated; Continental Grain Company; Farmers Export Company; Garnac Grain Company, Incorporated; Gold Kist, Incorporated; Goodpasture, Incorporated; Louis Dreyfus Corporation; Pasternak, Baum & Company, Incorporated; The Pillsbury Company; Tidewater Grain Company; and Tradigrain, Incorporated. The following table summarizes by commodity the purchased contracts. (See app. V for more detailed information.)

Commodity	Number of contracts	Quantity	Total value (note a)
		(1,000 metric tons)	(millions)
Corn	106	8,932	$1,343.9
Wheat	64	4,296	870.0
Soybeans	14	710	216.6
Soybean meal	16	400	101.5
Soybean oil	2	30	19.8
Total	202	b/14,369	b/$2,551.7

a/Value includes $162.8 million in rollover costs.

b/Total does not add due to rounding.

Contract resales

By a weekly bid process that ran from March 27 to August 7, 1980, the Corporation sold almost all the contracts. The soybean contract sales began in March 1980; corn, wheat, and soybean meal contract sales in May 1980; and soybean oil contract sales in July 1980.

Each week before the bids were opened, the Corporation determined acceptable prices for each delivery month and port by estimating current export prices, free on board vessel. Basically, the acceptable prices were derived by averaging market price quotes for each commodity at each port. Thus, the acceptable prices represented the commodities' market prices.

The bids received were listed by commodity, delivery month, and bid price. These lists along with the corresponding acceptable prices were submitted to a group of high-level Corporation officials. Accompanying this list was an updated table displaying the quantity of each commodity that was available for sale in each delivery month at each port.

Corporation officials used this information to determine which bids to accept. Because they did not want to disrupt or adversely affect market prices, they did not accept all bids over the acceptable price if they felt the quantity sold at any one time would affect market prices.

Early in the bidding process, there were a few interested bidders other than the exporters. However, for the most part only the exporters bid on the contracts. Each contract provided for delivering the grain at an export port. It seems reasonable that only exporters would be willing to buy contracts for delivery at export ports. If other grain users had purchased the contracts, they would have incurred additional costs for transporting the grain from an export port to wherever they needed it. Except for two cases, 1/ the Corporation sold all the contracts at less than it had paid for them. This resulted in a gross loss (before profit and short-inventory deductions) to the Corporation of about $475 million as shown in the following table.

1/A final determination on these two cases, which involve 100,000 metric tons of corn, will not be made until a disputed item on the exporter's profit statement is resolved. If the Corporation loses the dispute, these contracts will also be sold at less than their purchase prices. If the Corporation wins the dispute, the sale prices will be slightly more than the purchase prices.

Commodity	Quantity Purchased by Corporation	 Resold to original exporter	Percent of total	Total loss on all contracts (note a)
	--(1,000 metric tons)--			(millions)
Corn	8,932	6,883	77	$255.8
Wheat	4,296	3,182	74	143.7
Soybeans	710	534	75	53.4
Soybean meal	400	280	70	20.7
Soybean oil	30	22	73	1.4
Total	b/14,369	10,901	76	$475.0

a/Included in total loss is $18 million lost on contracts resold by other than the bid method. (See section below.)

b/Total does not add due to rounding.

At the time the Corporation was reselling the contracts, concern was expressed that the exporters might be in a position to reap windfall profits by buying back their original contracts at less than they had been sold for. Corporation officials said that many of the exporters' contracts to purchase grain to fulfill their Soviet sales were probably at higher prices than the prices that existed after the suspension was announced. As part of the Corporation/exporter agreement, exporters could not cancel these purchase contracts; thus, the higher priced purchases fulfilled the lower priced sales made subsequent to the suspension resulting in a loss to the exporters. When an exporter purchased its own contract, the resulting gain simply offset this loss. Data is not available, however, to determine if the gains partially, fully, or more than offset the losses.

Contracts resold by other than the bid method

The Corporation did not resell exporter contracts involving about 125,000 metric tons of corn and 440,000 metric tons of wheat. Before the Corporation's resale of corn and wheat contracts started, certain exporters, because of financial difficulties, asked the Corporation to settle on some of their contracts. Some of the delivery dates on these contracts had already been rolled over. These contracts were valued at about $102 million; the Corporation's loss in settling these contracts was about $18 million.

These contracts were settled in one of three ways.

--The Corporation purchased 200,000 metric tons of wheat owned by two exporters in country elevators. The Corporation's purchase price was the original contract price less transportation and handling charges.

- --The Corporation took delivery of 170,000 metric tons of wheat at an export port to be shipped to needy nations under the Public Law 83-480, Title II, Food Assistance Program. Settlement with the exporter was at the original contract price.

- --The Corporation negotiated sale prices with three exporters for 125,000 metric tons of corn and 70,000 metric tons of wheat. Of this wheat, 45,000 metric tons had originally been earmarked for shipment under the Public Law 480 program. The negotiated prices, based on then-current market prices, were used to settle the contracts.

In reviewing the Corporation's payment calculations for these settlements, we noted that on one exporter's two wheat contracts, the Corporation had credited the exporter with two rollover premiums--one for January through March 1980 and another for January through April 1980. We found that only one of the two premiums--the one for January through March--should have been credited. On June 19, 1980, we notified the Corporation of the apparent overpayment of about $606,000. Based on our review of the exporter's two wheat contracts, USDA's Office of Inspector General reviewed the Corporation's payment calculations for settlement of a third contract with the exporter and found an additional overpayment had been made. Additional adjustments were made for freight charges and interest, and on August [illegible], 1980, the exporter gave the Corporation a check for about $930,000 in settlement of the overpayments.

CORPORATION PURCHASE COST COULD HAVE BEEN LESS

Because of certain actions, the Corporation lost or will lose more than it should in purchasing and reselling the exporters' contracts. These actions included

- --questionable purchase of soybean and soybean product contracts,

- --inadequate deduction for exporters' short-inventory positions to recover exporters' potential gains, and

- --delays in determining exporters' deductions that will increase the Corporation's interest costs.

Questionable need to purchase soybean and soybean product contracts

The Corporation purchased contracts for 710,000 metric tons of soybeans, 400,000 metric tons of soybean meal, and 30,000 metric tons of soybean oil without justifying, as USDA's General Counsel had determined (see p. 12), that the farmer would be the primary beneficiary of such purchases. The Corporation purchased these contracts at a cost of about $338 million and resold the contracts for about $262 million, resulting in a loss of about $75.5 million.

The Corporation's basis for purchasing the exporters' contracts was to prevent the "complete disintegration of the U.S. grain marketing system." Although this appeared to be possible for corn and wheat, it is evident from the table below that if the exporters had dumped on the market all of the relatively small amount of soybeans and soybean products involved in the suspension, the impact on soybean prices and soybean producers would have been minimal.

Commodity	Quantity involved in Soviet contracts	Percent of 1979 production	Percent of 1979/80 exports
	(1,000 metric tons)		
Corn	8,932	4.5	14.7
Wheat	4,296	7.4	11.5
Soybeans	710	1.2	3.2
Soybean meal	400	1.5	5.6
Soybean oil	30	0.6	2.8

We recognize that exporters holding soybean product contracts may have incurred losses in selling these contracts or applying them to lower priced sale contracts. However, such potential losses should not have been used as the prime criterion for the Corporation's purchase. According to USDA's General Counsel, the Corporation should have demonstrated that the farmer was the primary beneficiary of the Corporation's action. In our opinion, the General Counsel's criterion should have been applied separately to each commodity involved in the suspension.

A USDA official told us that it was necessary to purchase soybean and soybean product contracts to offset the psychological impact of the suspension on soybean market prices. We believe that any possible psychological effect would have been short term. Once the market traders realized that the quantity of soybeans and soybean products involved in the suspension was minimal, prices probably would have begun to recover.

According to USDA (see app. VI), the purchase of soybean and soybean product contracts was necessary because these purchases would have a direct influence on stabilizing embargoed grain prices. It added that its position is that commodities directly related to the embargoed grains have direct influence on market prices.

We continue to believe that any impact on soybean and soybean product market prices caused by the suspension would have been minimal and short term. Thus, we still question the need to purchase these contracts.

Deduction for short-inventory position is inadequate

The short-inventory deduction is intended to remove potential profits an exporter could have gained as a result of purchasing grain after the suspension to fulfill its presuspension contracts with any purchaser. Basically, an exporter is in a net short-inventory position if the volume of its sale contracts is greater than the volume of its purchase contracts. The price of an export sale contract is generally based on the price of grain, exporter's cost, and a desired profit margin. If market prices decrease between the execution of the sale contract and the purchase of the grain to fulfill the contract, the exporter's profit margin would increase.

However, the short-inventory deduction, as defined in the Corporation/exporter agreement, applies only if the exporter had not fully covered its Soviet sales with grain purchase contracts before the suspension. It does not consider any potential profits on sales to other than the Soviet Union that the exporter could have gained by covering a short position with lower priced grain as a result of the suspension's adverse impact on market prices. We believe that in taking actions to offset the suspension's adverse impacts, the Corporation should have considered any potential benefits caused by the suspension.

Near the conclusion of the negotiations with the exporters on the agreement, the Corporation, at the request of USDA's Office of Inspector General, brought up the idea for a deduction if exporters were in a short-inventory position. The Corporation proposed to the exporters that a deduction be made if an exporter was in a short position at the close of business on January 4, 1980. The exporters disagreed and stated that no deduction was justified. They reasoned that the particular position that a company was in on January 4 was the result of day-to-day trading decisions and was totally unrelated to the Soviet sales.

Although the exporters believed that no deduction should be made, they proposed that if such a deduction should be included in the agreement, it be made only in those cases in which an exporter had not been in an even or long-inventory position--total sales volume equal to or less than total purchases--on any 1 day between the date of its last Soviet contract and January 4. The exporters said that if an exporter had been in an even or long position for even 1 day, it could be assumed that its Soviet sales were completely covered and no deduction should be made.

In late January 1980 USDA's Office of Inspector General informed USDA's General Counsel that the deduction as proposed by the exporters would not adequately remove the "windfall" profits caused by the suspension. The Inspector General said that the proposed deduction would not remove potential profits caused by the suspension on fulfilling sales to purchasers other than the Soviet Union. The Inspector General said the deduction should be based on each exporter's January 4 inventory position regardless of whether the exporter had covered its Soviet sales before January 4.

In a January 30, 1980, meeting, the Corporation's Board of Directors considered the Inspector General's objection to the proposed short-inventory deduction. The Board agreed with the exporters' argument and decided to accept their proposal. In March 1981 members of the Inspector General's staff told us that they continued to believe that the short-inventory deduction in the agreement does not adequately remove "windfall" profits.

We agree with the Inspector General's position on the short-inventory deduction. The announcement of the suspension caused many adverse impacts on all sectors of the U.S agricultural industry. The Corporation took actions, such as purchasing the exporters' contracts, to offset these adverse impacts. In considering the type and extent of offsetting actions to be taken, the Corporation should have also considered potential profits caused by the suspension. Thus, we believe an appropriate short-inventory deduction from the contract purchase price should have been based solely on an exporter's January 4 position.

Each exporter submitted a statement of its inventory position between the date of its last Soviet contract and January 4 to the Corporation. These statements are being used as the basis for calculating the deductions. The Secretary asked that the Office of the Inspector General verify these statements.

In March 1981 Inspector General staff members told us that the deductions for short-inventory positions would have been greater if January 4, 1980, had been used as the controlling date.

Delays in determining deductions will increase Corporation costs

As discussed on page 23, 3 percent of the contract purchase price, or about $70 million, was withheld by the Corporation pending settlement of the exporters' profit and short-inventory deductions. The Corporation/exporter agreement requires that interest on the amount of final settlement--withheld funds minus the deductions--be paid at the daily prime rate for the period between delivery month and final settlement. Because, for the most part, the prime rate exceeds the rate the Corporation pays to the Treasury to borrow funds, the Corporation's interest costs increase the longer it holds the exporters' funds. Delays by the Corporation and a three-member board of accountants in developing the standards and procedures to be used in computing the profit deduction stretched out the period between delivery month and final settlement, thus causing an increase in Corporation interest costs.

The Corporation/exporter agreement signed in February 1980 set forth the following conditions.

--The profit deduction was to be determined based on profit and loss statements submitted by the exporters for their grain merchandising operations over the 2 fiscal years preceding the suspension. The statements were to be prepared in accordance with accounting standards and procedures to be developed by a three-member independent board of accountants. One member of the board was to be selected by the Corporation, one by the exporters, and one by the American Institute of Certified Public Accountants. The board was also charged with deciding on any disputes between the Corporation and an exporter concerning the amount of the profit deduction.

--The short-inventory deduction was to be based on daily inventory position data supplied by the exporters.

The exporters did not submit their profit data until November 1980. Two exporters were granted an extension until January 1981 to submit their profit data. The delay in requesting and receiving this data was caused by the following factors.

--The Corporation did not name its representative to the board until late April 1980. Corporation officials told us the delay was caused by difficulties in finding an accountant knowledgeable about the grain trade who did not hold a position with a grain company or with a firm auditing a grain company.

--The board took about 4 months to develop a draft of the standards and procedures to be used in developing the profit and loss statement. On August 29, 1980, the board submitted to the Corporation a draft of the standards and procedures.

--The standards and procedures were not finalized and sent to the exporters until October 3, 1980, or about 8 months after the agreement was signed. The delay in finalizing the standards and procedures was caused by making minor adjustments. The exporters were given 30 days to submit their statements.

As of June 29, 1981, the Office of Inspector General had reviewed the data submitted by all but one exporter. Except for certain disputed items involving two exporters, the Inspector General had verified the data submitted. The Corporation had purchased contracts valued at $1.7 billion from the exporters reviewed by the Inspector General. A profit deduction of $4.8 million and a short-inventory deduction of $470,000 was identified. If the board accepts the Corporation's position on all disputed items, the profit deduction will increase by about $1.8 million. According to a USDA official, the latest Corporation data available shows that as of the end of May 1981, the Corporation incurred about $2.6 million in interest costs.

In commenting on this matter (see app. VI), USDA said that where a dispute had arisen with an exporter, settlement of amounts not in dispute had been made. As of July 7, 1981, final settlement had been made with nine exporters, and the amount withheld by the Corporation had been reduced from about $70 million to about $28 million.

Standards and procedures were not definitive

We believe the standards and procedures that the three-member board developed basically lacked a definitive structure of accounting standards and procedures that the exporters should follow in determining pretax profit margins. The board said that a definitive structure was not possible because no two exporters' accounting systems are alike. As a result, the board adopted a flexible approach in developing the standards and procedures.

Although we recognize that the exporters' different accounting systems inherently limited developing standard procedures, we believe that certain standards should have been more fully defined. For example:

--One standard allowed for the exclusion of extraordinary items from the profit calculation. It should have contained examples of extraordinary items to further clarify the definition of an extraordinary item.

--One standard defined the exporters' gross sales to include both foreign and domestic sales. The board said that from a practical standpoint, exporters would find it difficult to segregate domestic from foreign sales. This statement may not be accurate if exporters are following generally accepted accounting principles. The Financial Accounting Standards Board (FASB) is the standard-setting body for business enterprises. FASB Statement No. 30, Disclosure of Information About Major Customers, requires an enterprise to disclose the amount of revenue derived from sales to a foreign government if it is 10 percent or more of total revenues.

--One standard allowed the deduction of all direct and indirect costs of merchandising from total gross sales as part of determining pretax income. However, it did not define these costs or present an acceptable method for calculating them.

Inspector General staff members told us that they shared many of our concerns about the board's standards and procedures. They said that they had expressed these concerns to the board but were not able to convince the members to make such changes.

The staff members said that the flexible standards and procedures led to a disagreement between the staff and an exporter during verification of the exporters' statements. This disagreement will have to be decided by the three-member board, thus delaying final settlement.

CONCLUSIONS

The Corporation paid about $475 million more for purchasing the exporters' undeliverable Soviet contracts than it received when it resold them. Although much of this loss was unavoidable, the Corporation took certain actions which increased the loss.

These actions included (1) the questionable purchase of soybean and soybean product contracts without an economic justification that such purchases were necessary to benefit the farmer, (2) an inadequate recovery of potential exporter profits caused by the exporters covering their presuspension sales with lower priced postsuspension grain, and (3) delays in making payments to exporters which will increase the Corporation's interest costs.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

We recommend that if the Corporation again considers purchasing exporters' contracts to offset the impact of any future suspensions, the Secretary should direct it to

--prepare an economic justification for each commodity involved in the suspension to determine if such purchase is necessary and

--estimate any suspension-related benefits and detrimental effects to the exporters and use both estimates in determining the extent of Federal assistance needed.

CHAPTER 4

PROBLEMS ENCOUNTERED DURING DOMESTIC GRAIN PURCHASES

Between February 1980 and the end of June 1980, the Corporation made 11 separate purchases of wheat and corn to fulfill the President's commitment to remove from the market a quantity of grain similar to the quantity suspended from shipment to the Soviet Union. In total, the Corporation entered into 43,929 individual contracts with farmers and elevators to purchase 4.1 million metric tons of corn and 4.2 million metric tons of wheat at a cost of about $978 million. The Corporation estimates it will spend a total of $141 million by the end of fiscal year 1981 to store, handle, and transport the purchased grain.

On some of these purchases, the Corporation (1) paid substantially more than the market price, (2) purchased low-quality wheat at high prices, or (3) purchased wheat varieties not involved in the suspension. In addition, the Corporation experienced a variety of administrative problems in implementing the purchase program.

THE CORPORATION'S PURCHASE METHODS VARIED

To offset the suspension's impact on market prices, the Corporation acted to remove a quantity of corn and wheat from the market similar to the quantity involved in the suspension. During January and February 1980, except for a small corn purchase, the Corporation attempted to remove the corn by encouraging farmers to enter it in the farmer-owned reserve. It also announced it planned to purchase the 4.1 million metric tons of wheat--equal to the amount involved in the suspension--for use in a food security reserve. After deciding that the reserve approach was too slow in removing corn, the Corporation also announced it would purchase corn from farmers and elevators.

The Corporation's Board of Directors was directly involved in deciding on the methods to be used in purchasing the corn and wheat. In past purchases the Corporation's Kansas City Commodity Office had responsibility for operations. Although the Commodity Office was to handle the suspension-related purchases, Board members told us that the Board wanted to be heavily involved in this purchase program because (1) the Commodity Office was understaffed and (2) USDA headquarters wanted to closely monitor the quantities of grain purchased.

The early February 1980 corn purchase was made to alleviate congestion in corn storage facilities. Originally, invitations to bid were sent only to warehouses but, before the purchase was made, farmers were also given the opportunity to participate.

In early March 1980 the Corporation decided to start buying corn and wheat on a weekly basis. It said that purchases would continue until the quantities of corn and wheat purchased (plus in the case of corn the quantity added to the farmer-owned reserve) equaled the amounts suspended from shipment. Under the bidding method used, a farmer or warehouse could submit a bid to the Commodity Office at any time during a 15-day bidding period. The Commodity Office accepted all bids from a county that were at or below the Corporation's computed county market price. Some bids were also accepted above the computed price. (See following section.)

In early April 1980 the Corporation decided to change its wheat purchase method because the first two purchases of wheat had not removed sufficient quantities from the market. The Corporation posted a price in each county at which it offered to buy wheat. Only farmers were able to participate in this purchase. The Corporation accepted offers on a first-come, first-served basis until the total wheat purchases equaled the amount of wheat suspended from shipment. About 61 percent of the Corporation's wheat purchases were made under the posted-price method.

Except for the February corn purchase, which was based on county loan rates, and the March corn purchase, which was based on maximum State prices, the Corporation computed a county market price for all grain purchases. Each county's market price was computed based on a grain terminal market price. Generally, in grain merchandising, farmers sell to a local elevator which in turn sells to a terminal elevator which acts as a grain collection point for shipment to export facilities and domestic purchasers.

To determine the county price, the Corporation subtracted from the terminal price (1) the average transportation cost from the county to the terminal and (2) the local elevators' average handling charge. People knowledgeable in the grain trade told us that this is an acceptable method to determine county prices. For counties served by more than one terminal or where more than one transportation mode (truck and rail) was used, the Corporation calculated a county price for each combination and chose to use the highest price as the county market price.

CORPORATION DECISIONS INCREASED FEDERAL GRAIN PURCHASE COSTS

Certain Corporation actions in purchasing the corn and wheat substantially increased its grain purchase cost. We believe that much of this additional cost was not necessary. It is not possible, however, to determine if the purchase will result in a net gain or loss until the Corporation sells the grain.

Corporation paid over-market prices for the purchased grain

The prices the Corporation paid for most of the wheat and corn it purchased exceeded the computed market prices by 10 cents to 50 cents a bushel. In total, the over-market premiums amounted to $36.8 million on the bid purchases and $19.9 million on the posted-price purchase. The total, $56.7 million, represented about 6 percent of the Corporation's total purchase price.

According to some Corporation officials, over half of the premium amount was provided as an incentive to farmers to participate in the purchase program. We believe that if a critical oversupply situation existed, as Corporation officials suggested, such an incentive was not needed to induce participation.

The bids that the Corporation received and accepted on 95.6 percent of the wheat and 78.2 percent of the corn purchased through the bid method exceeded the computed market prices. Also, all the wheat purchased by the posted-price method--61 percent of the total wheat purchased--was purchased at over-market prices.

As shown in the following table, the premiums ranged from 10 cents to 50 cents a bushel. The premiums on the computed wheat prices varied depending on the type purchased.

Commodity	Purchase	Premium
		(cents per bushel)
Corn	Invitation 1	(a)
	" 2	(b)
	" 3	20
	" 4	20
	" 5	10
	" 6	10
	" 7	20
	" 8	20
Wheat	Invitation 1	20
	" 2	c/25 to 50
	Posted price	d/19 to 44

a/Purchases based on individual county loan rates rather than a computed price.

b/Purchases based on maximum price by State rather than computed price.

c/Premium depended on type of wheat purchased. Premium for hard red winter wheat was 50 cents; soft red winter wheat, 40 cents; and white wheat, 25 cents.

d/Premium depended on type of wheat purchased. Premium for hard red winter wheat was 44 cents; soft red winter wheat, 36 cents; hard red spring wheat, 33 cents; and white wheat, 19 cents.

Corporation officials told us that purchases at over-market prices were necessary to (1) adjust for the difference in market prices between the time the prices were calculated and the time the successful bidders were notified, (2) reflect a small amount for interest and storage costs that the Corporation believed the farmers would add to their bids, and (3) give farmers an incentive to participate in the purchase program. High-level Corporation officials, who were members of the Board, were unable to tell us what portion of the premium for each purchase represented the amounts added for (1) market price differentials, (2) interest and storage costs, and (3) incentive. The Inspector General's staff also unsuccessfully attempted to obtain such a breakdown. However, some Corporation officials have estimated that over 50 percent of the premiums was for incentive.

Because market prices were generally increasing throughout the purchase period, it is not unexpected that most bids received during the bid periods exceeded the prices computed prior to the periods. It appears reasonable that the Corporation would include this price increase in determining the bids it would accept. Also, the amount included to cover interest and storage costs appears reasonable. The Corporation anticipated that most farmers would increase their bids because they expected a delay in making final settlement.

We believe, however, that the Corporation should not have included an incentive amount in calculating its acceptable prices. Corporation officials said that the purchases were necessary to stabilize prices and to give farmers an additional outlet to sell their grain in those areas where elevators were overcrowded. If such a critical oversupply situation existed, the Corporation should not have found it necessary to add an incentive amount to the purchase prices.

In its comments (see app. VI), USDA said that inasmuch as the Corporation was attempting to purchase grain on a depressed market, a degree of economic incentive was necessary to acquire the desired amount of grain in a short period of time.

We do not argue the reasonableness of purchasing grain at above-market prices. In fact, as stated above, we believe it was reasonable that the Corporation would pay over-market prices to adjust for (1) any price increase during the bid period and (2) an amount to cover interest and storage charges that the Corporation anticipated most farmers would add to their bids. We do not believe, however, that an additional incentive amount increasing the amount paid above market prices to as high as 50 cents a bushel is a reasonable degree of economic incentive.

Corporation purchased low-quality wheat at unduly high prices

The Corporation's wheat invitation purchases specified U.S. grade number 2 or better wheat. Under the posted-price wheat purchase, the Corporation offered to take other grades of wheat at a discount from the posted price. As discussed in the preceding section, the Corporation's posted prices included premiums over the computed county market prices for market price differences, interest and storage costs, and incentive. The discounts for lower grades of wheat were less than the premiums. Thus, the Corporation paid higher prices for low-quality wheat than the computed county market prices for grade number 1 wheat. In addition, we believe that some of the lower quality wheat purchased will not serve its intended purpose.

The posted prices at which the Corporation offered to purchase wheat from farmers in early April 1980 were based on U.S. grade number 1 wheat. The Corporation said that it would accept delivery of wheat that failed to meet the standards for U.S. grade number 1, but that such wheat would be discounted as indicated in the table below. The Corporation stated that wheat that graded as sample--less than grade 5--would not be accepted.

U.S. grade	Discount per bushel
	(cents)
No. 2	2
No. 3	4
No. 4	6
No. 5	9

At the time of our review, about 98.5 percent of the nearly 94 million bushels of wheat purchased under the posted-price method had been graded. The following table shows that about 37 percent of this wheat was less than grade 1 and that the Corporation had purchased wheat that was less than grade 5.

U.S. grade	Wheat purchased	Percent of total purchase
	(bushels)	
No. 1	58,516,008	63.3
No. 2	25,983,781	28.1
No. 3	6,354,114	6.9
No. 4	1,055,065	1.1
No. 5	494,983	0.5
Less than no. 5	89,404	0.1
Total	a/92,493,355	100.0

a/As of December 1, 1980, about 1.35 million bushels had not been graded.

According to various groups in the grain-marketing trade, most farmers sell U.S. grade number 1 wheat. Lower grade wheat results from (1) method of harvest (foreign material gets mixed with the grain), (2) movement and handling of the grain, (3) deterioration from storage, and (4) improper storage.

Generally, lower graded grain was purchased at above-local-market prices for grade 1 wheat. For example, under the posted-price purchase method, the discount applicable for grade 5 wheat delivered and accepted was 9 cents a bushel, while the premium for grade 1 wheat ranged from 19 cents to 44 cents a bushel.

(See footnote to table, p. 36.) Thus, a farmer delivering grade 5 wheat still received a price substantially over the computed county market price for grade 1 wheat.

Most of the wheat the Corporation purchased is being stored for the Food Security Reserve. This reserve was established under the Food Security Wheat Reserve Act of 1980 (title III of Public Law 96-494, 94 Stat. 2578). Its purpose is to provide up to a 4 million metric ton wheat reserve (about 147 million bushels) for emergency humanitarian food needs in developing countries. Most wheat exported is grade 2 or better. According to a farmer organization, wheat usually loses one grade between the farmer and the export facility. Thus, much of the lower graded wheat purchased and currently stored in country grain elevators may not be suitable for emergency food use.

Corporation purchased types of wheat not involved in suspension

Although all wheat involved in the Soviet grain suspension was hard red winter wheat, Corporation officials decided that other wheat classes should be bought. We believe that only hard red winter wheat should have been purchased.

Hard red winter wheat is one of 5 major classes of wheat grown in the United States. Each class is used for a different purpose, although some classes can be used for more than one purpose. For example, hard red winter wheat is generally used in producing yeast bread and hard rolls, while white wheat is used in bakery products other than bread. In addition, although some overlap exists, certain geographic areas of the United States grow only one of the major classes of wheat. Hard red winter wheat is grown primarily in Illinois, Missouri, Kansas, Oklahoma, Texas, and Nebraska.

The following table shows the quantities offered and accepted by class of wheat. As the table indicates, enough hard red winter wheat was offered to constitute 100 percent of the wheat purchased by the Corporation. However, it purchased only about 58 percent of the hard red winter wheat offered.

Class	Quantity Offered	 Accepted	Percent accepted
	--------(bushels)--------		
Hard red winter	175,828,054	102,816,582	58
Hard red spring	42,688,553	36,285,269	85
Soft red winter	10,949,185	6,346,912	58
White wheat	26,503,998	8,762,824	33
Total	255,969,790	154,211,587	60

The Corporation decided to purchase other than hard red winter wheat because all wheat classes are used in foreign food assistance programs--the anticipated use for the purchased wheat. However, we believe that the purchase of wheat classes other than hard red winter wheat, or 33 percent of the wheat purchased in the posted-price purchase, did not adequately offset the suspension's impact on hard red winter wheat producers. Officials of the Kansas Wheat Commission told us that Kansas wheat farmers were angered by the Corporation's purchase of wheat classes other than hard red winter wheat. The officials said that the farmers stated that any purchase of wheat other than hard red winter meant less wheat would be purchased from the farmers actually hurt by the suspension--the hard red winter wheat growers.

In its comments (see app. VI), USDA said that buying other classes of wheat was necessary because the purchases would have a direct influence on stabilizing embargoed grain prices. Because hard red winter wheat was the only type of wheat involved in the suspension, we believe that the purchase of only hard red winter wheat would have had a much more direct influence on stabilizing the embargoed grain prices.

PURCHASE PROGRAM EXPERIENCED MANY ADMINISTRATIVE PROBLEMS

We visited 4 States and 15 county USDA Agricultural Stabilization and Conservation Service offices located in major corn and wheat production areas. (See app. IV.) Officials in most State and county offices visited stressed the program's administrative problems.

The Service's county offices are the first line of contact with farmers and grain warehouses. Thus, it is important that the county offices be made aware of all Corporation programs to assist farmers. However, except for the posted-price wheat purchase, the purchase program was administered by the Corporation's headquarters or Kansas City Commodity Office. According to many county office officials, the lack of timely and detailed instructions made it impossible for them to respond to the large number of farmer inquiries about the grain purchase program.

The first corn purchase was implemented in February 1980. Originally, Corporation officials decided that corn would be purchased only from warehouses, and they sent instructions and bid forms to many warehouses. State and county offices did not receive the instructions and forms and thus could not answer questions about the purchase. The Corporation later amended the instructions to allow farmers to bid, but county offices still did not have enough information on the purchase to assist farmers. Some county office officials told us that the purchase was completed before they knew much about it.

The dissemination of instructions to State and county offices did not improve when the Corporation began weekly purchases of corn and wheat in March. After the purchase was announced, State and county offices were deluged with inquiries from farmers. The offices could not answer these inquiries and referred them to the Corporation's Kansas City Commodity Office. County office personnel said that

- --their credibility with farmers was hurt due to their inability to answer farmer inquiries and
- --Commodity Office personnel gave out conflicting information on the purchases.

The posted-price wheat purchase was administered by the county offices. However, county offices did not receive the instructions to be used for the purchase until less than a week before the purchase. In many cases these instructions were oral rather than written. County officials told us that the

- --lateness in receiving the instructions created problems in notifying farmers about the purchase and
- --written and oral instructions were confusing.

In addition, the county offices did not receive directives concerning delivery of the wheat, refunding the handling charges, deducting storage charges, and making final settlement until after the purchase. County officials told us that such information is important in a farmer's decision to sell wheat to the Corporation.

County office personnel told us that the confusing and untimely instructions probably caused some farmers not to offer their grain to the Corporation.

CONCLUSIONS

On some purchases made to fulfill the President's commitment to remove suspended grain from the market, the Corporation paid substantially above the market price, purchased low-quality wheat at high prices, or purchased wheat varieties not involved in the suspension. In addition, the Corporation experienced a variety of administrative problems in implementing the purchase program.

The open-market purchase method appears to be a more rapid method than the reserve to remove suspended corn and wheat from the market. To have a maximum offsetting effect, however, such purchases should remove from the market only the types and quality of grain involved in the suspension.

RECOMMENDATION TO THE SECRETARY OF AGRICULTURE

We recommend that if the Corporation again considers open-market purchases as an offsetting action, the Secretary direct it to purchase only the types and grades of commodities suspended from shipment and to make such purchases at prices within a reasonable amount of the existing market price.

CHAPTER 5

MONITORING A GRAIN SALES SUSPENSION IS DIFFICULT

The primary objective of the Federal Government's efforts to monitor the grain sales suspension was to identify illegal shipments of U.S. grain to the Soviet Union. As of December 31, 1980, no illegal shipments had been substantiated, although 15 cases of alleged illegal shipments had been or were being investigated. Factors that limit the potential for detecting illegal shipments of U.S. grain in a suspension situation include the fungibility, or interchangeability, of grain; limited U.S. legal jurisdiction; and diplomatic and political considerations. Overcoming these limitations does not appear practical.

NEED FOR A MONITORING PROGRAM

On January 7, 1980, the President directed the Secretary of Commerce, in consultation with the Secretary of Agriculture and other appropriate officials, to take immediate action under the Export Administration Act to terminate shipments of U.S. agricultural commodities and products to the Soviet Union. The Secretary was authorized, however, to grant export licenses for wheat and corn to the Soviet Union up to the 8 million metric tons authorized in the U.S.-U.S.S.R. Grain Supply Agreement.

Two days later, Commerce issued interim rules in the Federal Register (45 F.R. 1883) to implement the President's directives. The rules, in part, placed exporters on notice that

--Commerce intended to closely monitor exports and reexports of agricultural commodities to assure that these commodities were not subverted through indirect shipment to the Soviet Union;

--a shipment of agricultural commodities made to a consignee in a country other than the Soviet Union with the knowledge that such shipment was intended to be diverted from the original destination to the Soviet Union would constitute a violation of the interim rules; and

--any violations of the rules would be subject to civil, criminal, and administrative penalties, including suspension of export privileges, fines up to five times the value of the export, and imprisonment for not more than 10 years.

Immediately after the suspension was imposed, the Secretary of Commerce announced that no U.S. agricultural commodity could be exported to the Soviet Union without a validated export license issued by Commerce. (In late January the Secretary announced that shipments of products not related to the Soviet feed/livestock complex would not need such licenses.) The Secretary said that validated export licenses would be issued for wheat and corn shipments to the Soviet Union until such shipments reached the annual level of 8 million metric tons.

The Compliance Division of Commerce's Office of Export Administration was charged with investigating allegations of illegal grain shipments to the Soviet Union. At the outset, Commerce did not anticipate taking any other actions to monitor shipments.

USDA officials believed that a more comprehensive monitoring program was necessary to ensure that U.S. grain was not being illegally shipped to the Soviet Union. This concern led to the formation of two groups in January 1980 to monitor the suspension.

First, USDA established a coordinating office to monitor the suspension of exports to the Soviet Union. The office had one full-time and two part-time employees. It was authorized to (1) prepare weekly reports on grain shipments to the Soviet Union and any rumors or allegations of illegal shipments, (2) communicate with USDA's foreign field officers, as appropriate, to gather information on the suspension's effectiveness, (3) develop follow-up information of suspected diversions to the Soviet Union, (4) coordinate its monitoring efforts with other U.S. agencies, and (5) develop analytical reports on grain flows between countries.

Second, USDA's Director of Economics, Policy Analysis, and Budget established a monitoring group comprised of policy-level officials from USDA, State, and Commerce and a representative from the Central Intelligence Agency. In addition to providing for an exchange of information among its members, the group requested and received information from the Department of the Navy on grain vessels leaving U.S. ports and arriving at various ports around the world.

The Government's monitoring effort was reasonably successful in identifying and/or discouraging U.S. grain shipments from proceeding directly to Soviet ports. However, the monitoring effort experienced problems in identifying possible transshipments of grain--shipments unloaded at foreign ports and then reloaded on other vessels or railroad cars destined for the Soviet Union. In our opinion, these problems were not due to deficiencies in the monitoring program, but rather are inherent in monitoring any grain sales suspension.

NO MONITORING PROGRAM CAN ASSURE COMPLIANCE

In a January 5, 1980, press conference, the Secretary of Agriculture said that the United States would do everything possible to prevent transshipments but that there was really no way they could be stopped. He estimated that 3 million metric tons of U.S. grain would probably be transshipped to the Soviet Union.

Officials involved in the monitoring effort told us that it is probable that transshipments occurred. USDA officials said, however, that they could not determine how much grain the Soviet Union had received through transshipments. The difficulties in identifying transshipments hindered investigations of alleged illegal shipments.

The following are the primary reasons transshipments are so difficult to identify.

--The fungibility of grain or soybeans makes it difficult to track their end use once they have been processed or stored in a foreign country. Although grain varieties can be identified using laboratory tests, U.S. grain cannot visually be distinguished from non-U.S. grain.

--Certain ports, particularly in Northern Europe, have transshipment facilities. Many European countries, especially those without ports, have their grain shipped to these ports where it is reloaded on railroad cars, barges, or other carriers for shipment to the importing country.

--Insufficient staff resources and limited U.S. legal jurisdiction make it impossible to monitor every grain shipment worldwide or conduct indepth investigations of all allegations of transshipments. Once grain is unloaded in a foreign country, the extent of monitoring subsequent shipments depends on the cooperation of the country and, very possibly, non-U.S. grain companies.

The Compliance Division of Commerce's Office of Export Administration investigates alleged violations of the Export Administration Act. As of December 31, 1980, 15 cases generally dealing with allegations of transshipments of U.S. grain or soybeans to the Soviet Union had been brought to the Division's attention. Three were still under investigation. The other 12 had been closed without any violation being proven.

OBSERVATIONS

A monitoring program is necessary in any grain suspension to identify illegal shipments. In our opinion, within staff and data limitations, the Federal Government's program to monitor the Soviet grain sales suspension was reasonably successful in identifying and/or discouraging possible diversions--shipments from U.S. ports going directly to Soviet ports instead of their original destinations.

However, it is not feasible to set up a monitoring program which would identify grain transshipments. Federal officials involved in the monitoring program suspect that such transshipments occurred, but they could not substantiate this or accurately estimate the amount.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our March 3, 1981, report, Agriculture, Commerce, and State Department officials agreed that monitoring any grain sales suspension is difficult because of (1) the fungibility of grain and soybeans, (2) the availability of transsshipment facilities, and (3) insufficient staff resources and limited U.S. legal jurisdiction.

Department of State officials told us that it was not necessary to monitor the destination of every vessel leaving U.S. ports. They said that the fact that a majority of vessels had been monitored discouraged exporters from attempting direct grain shipments to the Soviet Union. As noted on page 43, we agree that the Government's monitoring effort was reasonably successful in identifying and/or discouraging shipments from U.S. ports going directly to Soviet ports. We believe that the vessel-monitoring program was the primary reason for this success.

CHAPTER 6

IMPACT OF THE SUSPENSION ON THE SOVIET UNION

The Export Administration Act requires that the President submit a report to the Congress explaining the imposition of any foreign policy export controls. In January 1980 the President submitted a report to the Congress on the Soviet grain sales suspension. The President said that the suspension could reasonably be expected to bring home to Soviet leaders that they cannot act as they had acted in Afghanistan without paying a significant price.

The President added that the suspension would have a significant impact on the Soviet economy by causing a (1) major reduction in the availability of livestock feed, (2) distress slaughter of livestock which could not be fed, and (3) significant reduction, in due course, of Soviet meat production. The President based these estimates on the Soviet Union's inability to replace suspended U.S. grain. He said that contacts with other major grain-exporting countries indicated that they would substantially cooperate in limiting the Soviet Union's ability to replace U.S. grain.

However, according to USDA data for the 1979-80 marketing year, the availability of livestock feed, the numbers of livestock slaughtered, and the Soviet Union's per capita meat consumption were at about the same levels as in the previous year. USDA and State officials told us that the suspension could have had even less effect on the Soviet Union in the 1980-81 marketing year.

U.S. EXPORTS SUBSTANTIALLY OFFSET BY OTHER SOURCES IN 1979-80

Although it was expected that the suspension would have a significant impact on Soviet feed usage, livestock herds, and meat consumption during the 1979-80 marketing year, the Soviet Union was able to substantially offset the loss of U.S. grain by increasing its imports of non-U.S. grain and meat, using substitute feeds, and drawing down its carryover grain stocks.

Impact on imports, feed usage, and carryover stocks

As of December 1979, the month before the suspension, USDA estimated that the Soviet Union would import 34 million metric tons of grain during the 1979-80 marketing year, including about 25 million metric tons of U.S. grain. In January 1980 USDA estimated that the suspension would result in a net reduction in Soviet grain imports of 9 million metric tons (a decrease of 11 million metric tons of U.S. grain partially offset by an increase of 2 million metric tons of grain from other countries). According to USDA, the net shortfall of 9 million metric tons would cause a decrease of about 6 million metric tons, or about 5 percent, in Soviet feed usage and a drawdown of an additional

3 million metric tons of Soviet carryover grain stocks. Before the suspension, USDA estimated that the Soviet Union would have to draw down a total of 16 million metric tons of its stocks in 1979-80.

In October 1980 USDA published updated estimates 1/ indicating that the suspension had cut off 12 million metric tons of U.S. grain but that even with the suspension, the Soviet Union had imported a record 31 million metric tons of grain during the 1979-80 marketing year. The estimate of what the Soviet Union would have imported if the suspension had not occurred was increased from 34 million metric tons to 37 million metric tons. Comparing the imports of 31 million metric tons with the expected imports of 37 million metric tons, USDA estimated that the Soviet Union had experienced an import shortfall of 6 million metric tons.

The amount of the import shortfall may have been somewhat less, however, because other sources, including some USDA officials, indicated that Soviet port unloading facilities and other transportation limitations restrict Soviet grain imports to a maximum of between 32 and 36 million metric tons annually. Whatever the import shortfall might have been, however, USDA's estimates in February 1981 were that Soviet feed grain usage in 1979-80 was only about 2 percent (rather than 5 percent) less that the presuspension estimated usage and that the additional Soviet carryover stock drawdown was only 1 million (rather than 3 million) metric tons. Furthermore, Soviet feed grain usage in 1979-80, even with the suspension, was 1 million metric tons more than the 1978-79 level.

Impact on meat, milk, and egg production

One of the suspension's objectives was to adversely affect the Soviet goal of increased production of meat, milk, and eggs.

In an April 1980 report, 2/ USDA said that the latest Soviet plan, which was made before the suspension, set a meat output goal for 1980 of 15.7 million metric tons. This compared with 1979 meat production of 15.5 million metric tons. The report said that in view of the suspension, the 1980 goal did not appear to be within reach at that time, but it did not predict what the shortfall might be.

In October 1980 USDA reported that current indications were that 1980 meat output would reach only about 15.2 million metric

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1/"The U.S. Sales Suspension and Soviet Agriculture, An October Assessment," Economics and Statistics Service, USDA, Oct. 1980.

2/"USSR Agricultural Situation: Review of 1979 and Outlook for 1980," Economics, Statistics, and Cooperatives Service, USDA, Apr. 1980.

tons, down by 300,000 metric tons, or about 2 percent, from 1979 output. This would also be 500,000 metric tons less than the Soviet goal. At the same time, USDA reported that the Soviet Union had been able to maintain presuspension livestock levels.

The April 1980 report said also that the latest Soviet plan set a 1980 milk output goal of 95 million metric tons. In 1979 Soviet milk production totaled 93.3 million metric tons. The report said, however, that 1980 milk output would probably fall well below the goal not only because of the suspension but also because of poor roughage supplies in 1979-80, the reduced 1979 Soviet grain crop, and the declining performance in the Soviet dairy sector over the past 2 years. Again, USDA did not predict what the shortfall might be.

In its October assessment report, USDA estimated that 1980 Soviet milk output would be 91 million metric tons. This would be 4 million metric tons, or about 4 percent, below the 1980 goal and 2.3 million metric tons less than 1979's production.

The Soviet 1980 egg production goal, according to the April 1980 report, was 67.6 billion eggs. This compared with 65.6 billion eggs produced in 1979. The report said that because of the tight grain situation expected through at least mid-1980, 1980 egg output might be near to or slightly above the 1979 level. In October 1980 USDA reported that Soviet egg production during January through September 1980 rose 5 percent above the previous year. It added that because the poultry sector was apparently receiving preferential feed supplies, 1980 egg production would probably meet the Soviet goal.

Soviet actions taken in 1980 to offset suspension's impact

In addition to drawing down carryover stocks, the Soviet Union was able to substantially offset the loss of U.S. grain in the 1979-80 marketing year by

--increasing grain imports from other countries,

--increasing supplies and use of substitute feeds, and

--increasing meat imports.

According to USDA estimates, the Soviet Union was able to replace about half the suspended U.S. grain through shipments from other exporting countries. The estimates were that of the 12 million metric tons of U.S. grain suspended from shipment, the Soviet Union was able to replace 5.7 million metric tons from other grain-exporting countries.

USDA recognized that for the suspension to adversely affect the Soviet feed/livestock sector, the other major grain-exporting countries would have to cooperate with the suspension. Thus, on January 12, 1980, representatives of the major grain-exporting countries--the United States, Argentina, Australia, Canada, and the European Community--met in Washington to discuss the Soviet grain sales suspension. USDA officials said that the representatives from all countries informally agreed to cooperate with the suspension. The degree of cooperation varied by country, and specific quantities were not mentioned.

Of the 5.7 million metric tons of suspended U.S. grain that, according to USDA estimates, the Soviet Union was able to replace by imports from other grain-exporting countries, 3.9 million metric tons were shipped from the countries attending the January 12, 1980, meeting. The remaining 1.8 million metric tons were received from other countries, such as Eastern European countries, Sweden, Thailand, and Turkey.

In April 1980 USDA published estimates for the 1979-80 marketing year which indicated that without the U.S. suspension, Argentina, Australia, Canada, and the European Community intended to ship about 9.5 million metric tons of grain to the Soviet Union. More recent USDA statistics show that these countries actually shipped 13.4 million metric tons of grain to the Soviet Union during the marketing year.

USDA officials said that the additional 3.9 million metric tons were in accordance with the countries' statements of cooperation. They said that private traders in Argentina shipped an additional 2.1 million metric tons, but the Argentine Government did not encourage these sales. The additional 1.8 million metric tons shipped by Australia, Canada, and the European Community were the result of loading tolerances--most grain export contracts contain a clause allowing for a 5-percent or 10-percent variance from the contracted quantity--and presuspension sales identified as going to unknown destinations which were subsequently shipped to the Soviet Union.

The United States also suspended sales to the Soviet Union of about 1.1 million metric tons of soybeans and soybean products. The United States did not receive cooperation from other countries in restricting exports of soybeans, soybean products, and other substitute feeds to the Soviet Union. According to USDA estimates, the Soviet Union was able to completely replace the suspended U.S. soybean and soybean product shipments by increasing soybean imports from other countries. The Soviet Union was also able to obtain a variety of other substitute feeds.

The Soviet Union was able to further offset the effect of the suspension by increasing meat imports. To maintain annual per capita meat consumption at the 58 kilogram level, the Soviet Union imported a reported record volume of meat--about 700,000 metric tons, or about 2.5 kilograms per capita--in 1980.

IMPACT ON THE SOVIET UNION IN 1981

USDA officials told us that Soviet feed usage in the 1980-81 marketing year would probably be less than 1979-80 levels.

However, they believed that the decrease in feed usage would result mainly from a poor grain production year in the Soviet Union.

USDA estimated that Soviet grain production in 1980-81 would be about 189.2 million metric tons--about 10.2 million metric tons more than the 1979-80 production but about 3.8 million metric tons less than average Soviet grain production during the 1970's. Even though the Soviet Union was to receive about 7 million metric tons less U.S. grain in the 1980-81 marketing year than the previous marketing year, USDA estimated that it would be able to increase grain imports to a record 34.5 million metric tons--about 3.5 million metric tons more than 1979-80 grain imports. According to USDA, this record level of imports would be about equal to the Soviet capacity to import grain.

USDA officials stated that the Soviet Union would achieve record level grain imports by increasing imports principally from Canada, Argentina, Spain, and Eastern European countries. According to the officials, Canada had exported more grain to the Soviet Union during the first 5 months of the 1980-81 marketing year than during all of the previous marketing year. In addition, Argentina was expected to supply about 10 million metric tons of wheat and coarse grains in the 1980-81 marketing year.

USDA officials told us that the Soviet Union would have been forced to decrease feed usage by about 8 million metric tons, or 6 percent, even if Soviet grain imports were increased to 34.5 million metric tons. They said that poor grain production in the Soviet Union and low Soviet carryover stocks (although levels are not publicized) would cause the decrease in 1980-81 grain feed usage over the 1979-80 level.

The Soviet Union was also expected to be able to make up some of the decrease in feed usage by becoming more efficient in livestock feeding. USDA's October 1980 assessment report (see p. 47) said that Soviet livestock feeding has historically suffered from a serious protein deficiency which causes a 20- to 35-percent overexpenditure of feed in the production of beef and pork. Increased use of high-protein feeds, such as soybean meal, peas, vetch, and fishmeal, could improve livestock slaughter weights without expanding the total quantities of feed consumed. The Soviet Union may also have been able to make up some of the decrease in feed usage by increasing its use of forage crops and feed substitutes, such as manioc. The degree to which these actions would have offset the suspension's impact cannot be quantified.

USDA also predicted that due to tight grain supplies, Soviet meat production in 1981 would be at or below the 1980 level. In addition, USDA officials told us that the reported record level meat imports would continue in 1981. They also said that sufficient data was not available to accurately forecast Soviet per capita meat consumption in 1981.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our March 3, 1981, report, USDA officials said that the suspension had a minimal impact on the Soviet Union during the 1979-80 marketing year and was having even less of an impact in 1980-81. They believed that a decrease in Soviet feed usage and/or meat production during the 1980-81 marketing year would result mainly from a poor production year in the Soviet Union. According to these officials, during the 1980-81 marketing year, the Soviet Union would import an amount of grain about equal to its import capabilities.

State Department officials believed that the suspension had a significant impact on Soviet grain imports when measured on the basis of the October 1979 through September 1980 agreement year. (See p. 1.) They said that during the agreement year Soviet grain imports were 8 to 9 million metric tons less than anticipated.

We used the July 1979 through June 1980 marketing year to measure the suspension's impact because, according to USDA, the July-June period is more meaningful since it corresponds more closely to the availability of domestic crops. In addition, available USDA data on Soviet feed usage and other related Soviet agricultural sectors is usually reported on a July through June basis. Using an October through September year to measure the suspension's impact would have limited the measurement to changes in Soviet grain imports. As discussed on page 46, the anticipated impact of the suspension was to cause a reduction in the availability of livestock feed; distressed livestock slaughter; and, in due course, a significant reduction in meat production. Measuring the suspension's impact on these factors dictated the use of a July through June marketing year.

State Department officials believed that the suspension's impact on Soviet grain imports in the 1980-81 marketing year would have been less than the previous marketing year. However, these officials believed that the suspension would have continued to result in (1) decreased Soviet port efficiency, (2) higher Soviet grain import prices, and (3) a less than optimum Soviet livestock feed mix. We agreed that because of the suspension, the Soviet Union was paying higher prices for grain imports and that Soviet port facilities may have been overtaxed.

As discussed on page 50, livestock feeding in the Soviet Union before the suspension suffered from a serious protein deficiency which caused a 20- to 35-percent overexpenditure of feed in the production of beef and pork. Very possibly the suspension caused a move toward increased imports of high-protein feeds, such as soybeans, which may have actually increased Soviet feeding efficiency.

The Department of Commerce had no comment on the suspension's impact on the Soviet Union.

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April 22, 1980

Mr. Elmer B. Staats
Comptroller General
of the United States
General Accounting Office
Washington, D. C. 20548

Dear Mr. Staats:

As you know, on January 4, 1980, President Carter announced the imposition of a grain embargo with respect to shipments of grain to Soviet Russia. Technically, we believe the embargo took effect on January 7, 1980. The original announcement on January 4 and the briefing given at the Department of Agriculture on January 5 generally indicated that the sales agreements which existed between the grain exporters in this country and Soviet Russia were the sole responsibility of the grain exporters to resolve in the marketplace.

However, on Sunday, January 6, 1980, Administration officials met with grain exporters and after that meeting, it was announced that there would be an assumption of the sales agreements between the grain exporters and Soviet Russia by the Federal Government. Subsequently, the U.S. Department of Agriculture (USDA) and the grain exporters entered into agreements whereby those sales agreements between grain exporters and Soviet Russia were in fact assumed by USDA. General, but not specific, cost estimates for this assumption of agreements have been released.

It is our understanding that there has been some monitoring of this issue of the assumption of agreements of the grain exporters by USDA by the General Accounting Office (GAO). There also are indications that a special subcommittee of the House Government Operations Committee will be looking into this matter in the near future. However, it does appear that it would be in the interest of the Congress for GAO to investigate the circumstances surrounding the assumption of the grain exporter agreements with Soviet Russia to determine whether or not the agreements gave certain advantages to the grain exporters that have not been accorded to the farmers who have had to bear a substantial burden of the grain embargo as well as other matters relating to the legality of the assumption of such agreements.

Mr. Elmer B. Staats
April 22, 1980
Page 2

In addition, when President Carter imposed the grain embargo, Administration officials promised that there would be a close monitoring of grain shipments overseas to insure that no U.S. grain was shipped or transshipped to Soviet Russia. Newspaper and magazine accounts in recent weeks have suggested that Soviet Russia is in fact receiving U.S. grain. It appears to us that it is important for Members of this committee and the Congress to know whether or not there can be an effective monitoring program of any grain embargo, including that imposed by President Carter on grain shipments on January 4, 1980.

Finally, USDA (through the Commodity Credit Corporation) has proceeded to purchase grain under its special purchase program under a bid procedure system. We have received some charges that the bid procedures were discriminating against certain farmers or favored purchases from country elevators as opposed to farmers and producers. Moreover, there have been claims made by certain producers that the variations in prices offered in certain localities tended to be unfair and discriminatory against certain other producers and potential sellers.

We would appreciate it very much if you would investigate the three areas of concern mentioned above that have arisen directly or indirectly due to the embargo initiated by President Carter. Your assistance in providing us with this kind of study and investigation would be extremely helpful to the Members of Congress. It may well be that we will wish to introduce legislation based on the findings of the General Accounting Office as it relates to this entire matter.

With kind regards.

Sincerely,

Bill Wampler
William C. Wampler

Tom Coleman
E. Thomas Coleman

Keith G. Sebelius
Keith G. Sebelius

Tom Hagedorn
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1st District, Nebraska

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May 16, 1980

Mr. Elmer B. Staats
Comptroller General
of the United States
General Accounting Office
Washington, D.C. 20548

Dear Mr. Staats:

It has recently been called to my attention that six of my colleagues, who happen to be members of the House Agriculture Committee, have contacted the General Accounting Office regarding certain questions relating to the imposition of the grain embargo on the Soviet Union.

Specifically, these members have asked the GAO to investigate; (1) whether certain agreements have given advantages to grain exporters; (2) whether the United States has sufficiently monitored grain shipments to see that no shipment has been redirected to the Soviet Union and, (3) whether the bid procedures being adhered to by the Commodity Credit Corporation discriminated against certain farmers or favored purchases from county elevators as opposed to farmers and producers.

I wish to associate myself with this investigative request by my colleagues and request that any responses from GAO on this matter also be addressed to me. Thank you for your consideration of this request.

Sincerely,

Doug Bereuter

DOUGLAS BEREUTER
Member of Congress

DB/djd

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CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

May 6, 1980

Mr. Elmer B. Staats
Controller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Staats:

As you know, on January 4 in response to the Soviet invasion of Afghanistan the President suspended all grain shipments to the USSR in excess of the 8 million tons per year committed for sale under the five-year sale agreement. In making the announcement, the President said that he was determined to minimize any adverse impact on the American farmer from this action.

On January 7, the Vice President announced that the Commodity Credit Corporation would purchase all grain above the 8 million ton level as well as all soybeans and soybean products that exporting companies had contracted to sell to the Soviet Union. These contracts are now being retendered to many of the same companies they were purchased from at much lower prices and even further depressing markets. By USDA's own estimates, they will spend more than $800 million of the taxpayer's money to prevent the grain companies from losing $300 million.

In the meantime, prices that farmers receive for their grain have fallen substantially and none of the actions supposedly taken for farmers have had an appreciable affect.

While I believe that USDA personnel are trying to make the best of a bad situation, it is evident that the steps taken by the Administration have been wholly inadequate and grossly inefficient. I would therefore request that GAO make a full investigation of the actions taken and report to the Congress on your findings.

Sincerely,

Glenn English

Glenn English, M.C.

GLE/ljs

AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE

STATE AND COUNTY OFFICES VISITED

State	Counties
Iowa	Hamilton
	Pocahontas
	Polk
	Wright
Kansas	Cowley
	Dickinson
	Harper
	McPherson
	Sumner
Nebraska	Gage
	Lancaster
	Saline
Oklahoma	Kay
	Logan
	Noble

SUMMARY OF PURCHASE AND RESALE OF EXPORTERS' GRAIN CONTRACTS, BY COMMODITY

Commodity	Quantity	Assumption dollar value	Resale dollar value	Provisional loss (note a)
	(1,000 metric tons)	(millions)		
Corn	8,932	$1,343.9	$1,088.1	$255.8
Wheat	4,296	870.0	726.3	143.7
Soybean	710	216.6	163.1	53.4
Soybean meal	400	101.5	80.8	20.7
Soybean oil	30	19.8	18.4	1.4
Total (note b)	14,369	$2,551.7	$2,076.8	$475.0

a/Provisional loss represents Corporation's loss before deductions for exporters' profits and short-inventory positions. (See ch. 3.) Numbers may not add due to rounding.

b/Totals may not add due to rounding.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

JUL 7 1981

The Honorable Milton J. Socolar
Acting Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Comptroller General:

This is in response to Mr. Henry Eschwege's request for our comments on the Draft Report "Problems in Offsetting the Impact of Soviet Grain Sales Suspension -- Lessons Learned for the Future?"

The Draft Report does not deal with the question of whether the suspension of sales by President Carter was an appropriate or prudent foreign policy action, but rather examines certain related aspects of the suspension. These aspects include the efforts undertaken by the Department of Agriculture to offset the domestic impact of the suspension, the monitoring of shipments of grain to the Soviet Union, and the impact of the suspension on the Soviet economy.

This Administration is strongly opposed to the use of export controls in a manner which unfairly burdens any sector of the American economy. It is important to note that this Administration did not invoke the partial grains embargo -- it revoked it.

While it may be useful to discuss the possible adverse impacts of an overall U.S. trade suspension upon the agricultural community, it should be recognized that the affects of such embargoes can not be readily quantified. Not only did the past agriculture embargo appear to be only minimally effective with respect to its intended objectives, contingency planning for future unexpected disruptions of agricultural trade is extremely difficult, if not impractical, in light of such unpredictable variables as global weather conditions, world crop supplies and prices, the world economic situation trading pattern, and overall trade relations with our trading partners.

We have developed the attached staff paper which discusses various points raised by the Draft Report. We hope that these comments will prove useful to you in preparing a final draft of the report for the Congress.

Sincerely,

John R Block

JOHN R. BLOCK

STAFF COMMENTS
ON
DRAFT REPORT "PROBLEMS IN OFFSETTING THE IMPACT OF SOVIET GRAIN SALES SUSPENSION--LESSONS LEARNED FOR THE FUTURE" [1]

I. Confidential Information

The Draft Report contains various items of information relating to individual exporters which the Department has to date refused to release on the grounds that such data is confidential business information. Generally, the Department has refused to release any information as to individual exporters which is contained in Schedule A, columns 1 and 2 of the CCC-Exporter Agreement.

The Department is in the process of preparing to reevaluate this position. The exporters were asked to submit their views on this matter by June 19 and the Department is currently reviewing those submissions. Pending completion of this review and any change in the Department's position, the Department requests that GAO delete information relating to the individual exporters from the report. We believe that this information is not critical to the substance of the GAO report.

[GAO COMMENT: The information was deleted on advice of our General Counsel.]

II. General Comments and Corrections

1. On page 13, the Draft Report states that raising price support loan rates to pre-suspension market price levels could have eliminated the need for the purchase of exporters' contracts as a means of supporting prices. We do not agree that this would have been an appropriate action. The embargo had the effect of reducing demand relative to supply and tended to depress market prices. To have raised loan rates would have caused CCC to become the principal source of credit and sharply increased the non-recourse loans extended to producers as well as making disbursements to adjust existing rates for the then current crop already under loan. Unless market prices would have reached levels to make redemption profitable (loan rate plus interest plus storage costs) CCC would have become the owner of the grain which would have, eventually, the same implications as direct purchases. Moreover, extreme difficulty would have been encountered in reducing loan rates to

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[1] The staff comments section of the Department's letter was re-typed to facilitate showing our comments. The page numbers were changed to reflect those in the final report.

levels more commensurate with their stated purposes once the situation had been corrected.

[GAO COMMENT: See our evaluation on pp. 13 and 14.]

2. The term "rollover" or delayed delivery referred to on page 23 needs clarification. Reasons for rescheduling were due to time required to consummate assumption agreements and to establish administrative procedures.

[GAO COMMENT: Clarification added as suggested.]

3. On page 25, the Draft Report states that CCC computed "acceptable prices" for each port and delivery month before receiving competitive bids. CCC actually estimated current export prices, f.o.b. vessel. In general, sales of the contract rights occurred when bid prices equalled or exceeded the estimated f.o.b. export price for the applicable port range and delivery month.

[GAO COMMENT: Revised as suggested.]

4. The statement on page 25 to the effect that all contracts were sold at less than purchase prices is incorrect. In two instances contracts were sold at prices greater than their purchase prices.

[GAO COMMENT: Statement revised and footnote added on p. 25.]

5. On pages 26 and 27, the Draft Report discusses three ways in which contracts were settled out of tender. The first sentence of the third method should be reworded to read:

> -The Corporation negotiated sales prices with two exporters for about 125,000 metric tons of corn and 25,000 metric tons of wheat....

The following should be added at the end of the second method:

> ...About 215,000 metric tons of wheat were originally earmarked by the Corporation for shipment under P.L. 480 Title II food assistance. Since orders under the program were less than the earmarked quantity, settlement with the exporter for the remaining 45,000 metric tons was made at negotiated sales prices.

[GAO COMMENT: Our emphasis in presenting these three methods is to show what actually took place. Based on USDA's comment, a sentence was added to the third method on p. 27 to show that 45,000 metric tons of wheat had originally been earmarked for the Public Law 480 program.]

The Draft Report also discusses on page 27 the refund to CCC of about $930,000 because of an error in rollover premiums. It should be noted that the total amount recovered was not all due to GAO's recommendation, nor was it all excess rollover premiums. The entire preliminary settlement on the two contracts in question was thoroughly analyzed, and adjustments were made in both rollover premiums and freight charges. In addition, the exporter paid interest to CCC on the overpayment at average prime rates.

[GAO COMMENT: Paragraph revised.]

6. On pages 30 and 31 the Draft Report implies that in the event disputed settlements involving the 3 percent withheld payments are not made until resolution of the dispute, it will result in increased CCC interest costs. Where a dispute has arisen, settlement of amounts not in dispute has been made. At this time only one submission has been made involving two items with one exporter. Final settlements have been completed with nine exporters. The amount withheld by the Corporation has been reduced from about $70 million to about $28 million. It is estimated that exporter audits on the above will be completed by July 15, 1981.

[GAO COMMENT: Report section was updated based on this comment and additional data supplied by USDA.]

7. The Draft Report concludes that the farmer-held grain reserve program was ineffective in that it failed to remove 9 million tons of grain from the market as anticipated. We tend to disagree with the assumption inasmuch as the farmer-held reserve, established prior to the suspension of sales, had an announced purpose other than to withhold supplies of commodities for an unusual occurrence such as the grain embargo. The program was established to offer price and income support to producers of grain who participated with USDA in other farm programs. The integrity of this program had to be considered by USDA officials as it related to actions contemplated subsequent to the grain embargo.

[GAO COMMENT: See our evaluation on p. 21.]

8. The direct purchases by the Department to stabilize commodity markets are questioned by the Draft Report in regard to "high prices" paid by CCC. We disagree that the purchases should have been at current market prices inasmuch as CCC was attempting to purchase on a depressed market and a degree of economic incentive was necessary to acquire the desired amount of grain in a short period of time.

[GAO COMMENT: See our evaluation on p. 37.]

9. The Draft Report cites purchases of "wrong classes" of wheat, soybeans and soybean products, and concluded that this was inappropriate. Our position is that commodities directly related to the embargoed grains have direct influence on market prices. Therefore, the purchases would have a direct influence on stabilizing embargoed grain prices.

[GAO COMMENT: See our evaluation on pp. 28 and 40.]

10. To assist in your analysis of the assumption of export contracts by the Department, we have attached a Departmental release entitled "The CCC Assumption of Grain Exporting Contracts, No. 26", which essentially described the Department's rationale pertaining to rollover contracts and settlement of the purchase and resale of the export contracts from 13 grain companies.

[GAO COMMENT: Attachment not included in report.]

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